THAI NGUYEN UNIVERSITY - INTERNATIONAL SCHOOL

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IDEAS, CREATIVITY AND ENTREPRENEURSHIP

THAI NGUYEN UNIVERSITY PUBLISHING HOUSE

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PREFACE

Ideas, creativity and entrepreneurship are emerging issues in Vietnam, which are contemporarily discussed both in practical business and management and academia. This textbook serves as an official textbook for the courses related to issues of ideas, creativity and entrepreneurship. The textbook **Ideas, Creativity and Entrepreneurship** provides introductory knowledge and skills about generating ideas, enhancing creativity, building up a new venture and acting as entrepreneurs. Case studies and practical examples, from Vietnam and other countries are provided to illustrated the central topics of this area including idea generation, creativity, feasibility analysis, business model, competition analysis, business plan, legal and ethical foundation, new venture team, and financing for new ventures. Review questions are also included to facilitate students' learning and revision.

This book includes nine chapters as follows:

CHAPTER 1: OVERVIEW OF IDEAS, CREATIVITY, AND ENTREPRENEURSHIP

Chapter 1 provides introductory overview about the concepts of ideas, creativity and entrepreneurship. Students are expected to understand the rationale of decision to become entrepreneurs, discuss about common myths of entrepreneurship and impacts of entrepreneurship and entrepreneurial firms socio-economic aspects

CHAPTER 2: FUNDAMENTALS OF OPPORTUNITY RECOGNIZTION AND IDEA GENERATION

Chapter 2 presents fundamental content regarding opportunity recognition and idea generation in marketplace. To be specific, the chapter mentions four key components of what is so-called "a real opportunity", including attractive, durable, timely, and anchored in a valued-added product, service, or business. Meanwhile, the three ways facilitating opportunity

identification involve studying environmental trends, addressing a particular problem and detecting business gaps. Also, this chapter introduces four keen techniques for new idea generation, namely brainstorming, focus groups, Internet research and a collection of other means.

CHAPTER 3: FEASIBILITY ANALYSIS AND ENTREPRENEURSHIP

Chapter 3 provides introductory overview about feasibility analysis. Students are expected to understand the importance of feasibility analysis, from perspectives of product/service feasibility analysis and industry/market feasibility analysis. This chapter describes organizational feasibility analysis and financial feasibility analysis, along with two primary issues to consider when completing these analysis. A feasibility analysis template is presented to furnish students with practical tool for feasibility analysis.

CHAPTER 4: BUSINESS MODEL FOR ENTREPRENEURSHIP

In this chapter, the business models and their importance will be discussed firstly. Then, we describe a pattern for developing the business model, namely the Barringer/Irish Business Model Template. This model provides a general outline of the elements of a company's business model, which comprises 4 categories and 12 items. An important principle similar to the feasibility analysis is that the business model of the company should not be completed in isolation. Company founders should "get out of the building" and talk to potential customers as the company's business model takes shape. This is the aspect of developing an effective business model that we emphasize throughout the chapter.

CHAPTER 5: INDUSTRY ANALYSIS AND NEW VENTURES

This chapter introduces different concepts and frameworks for industry and competitor analysis. The first section of the chapter discusses industry analysis, which is business research that focuses on the potential of an industry and explain how to evaluate the level and nature of competitive behaviours by applying Michael Porter’s Five Forces Model. The chapter’s second section is concerned with a competitor analysis which is an analytical assessment of the behaviours of the firm’s competitors.

CHAPTER 6: BUSINESS PLAN - TEMPLATE FOR A NEW VENTURE

This chapter provides an introductory overview about a business plan. A business plan can make or break a small business. A strong, detailed plan provides a clear road map for the future, forces you to think through the validity of a business idea, and can give you much greater understanding of the business's financials and the competition. In a successful company business and strategic situations are thought about continually and decisions are made early enough in order to act successfully within the market.

CHAPTER 7. ETHICAL AND LEGAL ASPECTS OF A NEW VENTURE

This chapter will begin with a discussion of the most important initial ethical and legal issues facing a new firm, including establishing a strong ethical organizational culture, choosing a lawyer, drafting a founders' agreement, and avoiding litigation. This will be followed by the identification of the licenses and permits that may be needed to launch a business, along with the different forms of business organization, including sole proprietorships, partnerships, corporations, and limited liability companies.

CHAPTER 8: HUMAN RESOURCES AND NEW VENTURES

In this chapter, we focus on how the founders of an entrepreneurial venture build a new-venture team as well as the importance of the team to the firm's overall success. Elements of a new venture team are also discussed and the roles of each new venture team element are presented.

CHAPTER 9: FINANCIAL ISSUES OF ENTREPRENEURSHIP

In this chapter, the importance of financing for entrepreneurial success is firstly emphasized, and then we describe two forms of capital in the corporate's capital structure. We follow this with a description of personal funding by explaining three sources including personal funds, capital from friends and family and bootstrapping in the early stage of a firm. When the initial capital exceeds the company' needs, entrepreneurs need to prepare a detailed three-step plan to raise capital through equity funding and debt financing. Finally, we discuss some other creative financing methods available to entrepreneurial ventures.

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Thank you all for keeping this book so interesting!

CHAPTER 1: OVERVIEW OF IDEAS, CREATIVITY, AND ENTREPRENEURSHIP

Abstract: Chapter 1 provides introductory overview about the concepts of ideas, creativity and entrepreneurship. Students are expected to understand the rationale of decision to become entrepreneurs, discuss about common myths of entrepreneurship and impacts of entrepreneurship and entrepreneurial firms socio-economic aspects.

Learning Objectives

By the end of this chapter, students will be able to:

1. Describe entrepreneurship, corporate entrepreneurship, and the characteristics of entrepreneurial firms

2. Discuss three main reasons people decide to become entrepreneurs

3. Identify four main characteristics of successful entrepreneurs

4. Explain five common myths regarding entrepreneurship

7. Discuss the positive effects of entrepreneurship and entrepreneurial firms on economies and societies

Case Study: Vietnamese successful entrepreneurs

A lot of people have been to The Coffee House for a delicious cup of coffee or tea, but perhaps not many have heard of the stories of its CEO and the reason behind its establishment. The Coffee House was co-founded by Nguyen Hai Ninh, who is also the founder of Urban Station. However, he left the latter and dedicated to building The Coffee House chain. Ninh came to realize that the purpose of setting up a coffee shop is not to sell tea, coffee and other beverages, but to connect people and bring them a relaxed atmosphere. This is why The Coffee House brand came into existence.

Till April of 2017, The Coffee House has managed to open 43 outlets, many of which are located in prime locations in big cities. By that time, The Coffee House had also received 1.8 million USD in investment capital and earned 7 million USD in revenue.

According to Ninh, there are 3 factors that draw customers to the brand: The layout of the shops, customer service and benefits brought by the brand. At present, café businesses are undergoing increasingly cut-throat competition to attract customers. Hence café chains have to frequently update drinks and decor to cater to their customers' changing tastes.

Because of his achievements and his inspiration to the young people, Nguyen Hai Ninh made it to Forbes' Asia "30 Under 30" list in 2015.

Questions:

1. What is the newness of the Coffee House compared to traditional coffee shops in Vietnam?

2. What makes Nguyen Hai Ninh become one in Forbes' Asia "30 under 30" list?

Source: Top 5 Vietnamese successful entrepreneurs (https://fancydistrict.com/list/top-5-vietnamese-successful-entrepreneurs)

1.1. Entrepreneur and Entrepreneurship

- **Entrepreneur**

The word **entrepreneur** originated from the French words **entre** (which means "between") and **prendre (**which means "to take") The word **entrepreneur** was formerly used to represented people who "take the risk" or who "undertake" a task (e.g., starting a new venture). "Entrepreneur" is distinct from "Inventor". Inventor indicates who creates new thing(s). Meanwhile, Entrepreneur refers to a person who combines and integrates all the necessary resources (such as money, people, business model, strategy, and the risk-bearing ability) to transfer the invention into a feasible business.

• **Entrepreneurship**

Entrepreneurship refers to the process by which individuals pursue opportunities without regard to resources they currently control for the purpose of exploiting future goods and services. Others, such as venture capitalist Fred Wilson, define it more simply, that entrepreneurship can be seen as the art of turning an idea into a business. In essence, an entrepreneur's behavior finds him or her trying to identify opportunities and putting useful ideas into practice. The tasks called for by this behavior can be accomplished by either an individual or a group and typically require creativity, drive, and a willingness to take risks.

This book focus on entrepreneurship in the context of an entrepreneur or team of entrepreneurs launching a new business. However, ongoing firms can also behave entrepreneurially. Typically, established firms with an entrepreneurial emphasis are proactive, innovative, and risk-taking.

One of the most persuasive indications of entrepreneurship's importance to an individual or to a firm is the degree of effort undertaken to behave in an entrepreneurial manner. Firms with higher entrepreneurial intensity regularly look for ways to cut bureaucracy.

1.2. Rationale of being entrepreneurs?

The three primary reasons that people become entrepreneurs and start their own firms are to be their own boss, pursue their own ideas, and realize financial rewards.

1.2.1. Be their own Boss

The first of these reasons-being one's own boss-is given most commonly. This doesn't mean, however, that entrepreneurs are difficult to work with or that they have trouble accepting authority. Instead, many entrepreneurs want to be their own boss because either they have had a long-time ambition to own their own firm or because they have become frustrated working in traditional jobs.

Some entrepreneurs transition from a traditional job to owning their own more gradually, by starting their business part time to begin with. While this approach isn't possible in all situations, by starting a business part time individuals can gain valuable experience, tuck away the money they earn, and

find out if they really like the business before deciding to leave their job. In some businesses, such as catering or financial planning, it takes time to build a client list. Some entrepreneurs will time their departure from their job with the point in time where their client list is large enough and profitable enough to support a full-time business.

1.2.2. Pursue their own ideas

The second reason people start their own firms is to pursue their own ideas. Some people are naturally alert, and when they recognize ideas for new products or services, they have a desire to see those ideas realized. Corporate entrepreneurs who innovate within the context of an existing firm typically have a mechanism for their ideas to become known. Established firms, however, often resist innovation. When this happens, employees are left with good ideas that go unfulfilled. Because of their passion and commitment, some employees choose to leave the firm employing them in order to start their own business as the means to develop their own ideas.

This chain of events can take place in non-corporate settings, too. For example, some people, through a hobby, leisure activity, or just everyday life, recognize the need for a product or service that is not available in the marketplace. If the idea is viable enough to support a business, they commit tremendous time and energy to convert the idea into a part-time or full-time firm.

1.2.3. Pursue financial rewards

Finally, people start their own firms to pursue financial rewards. This motivation, however, is typically secondary to the first two and often fails to live up to its hype. The average entrepreneur does not make more money than someone with a similar amount of responsibility in a traditional job. The financial lure of entrepreneurship is its upside potential. People such as Jeff Bezos of Amazon.com, Mark Zuckerberg of Facebook, and Larry Page and Sergey Brin of Google made hundreds of millions of dollars building their firms. Money is also a unifier. Making a profit and increasing the value of a company is a solidifying goal that people can rally around. But money is rarely the primary motivation behind the launch of an entrepreneurial firm. Some entrepreneurs even report that the financial rewards associated with entrepreneurship can be bittersweet if they are accompanied by losing control of their firm. For example, Sir Richard Branson, after selling Virgin Records,

wrote, "I remember walking down the street [after the sale was completed]. I was crying. Tears … [were] streaming down my face. And there I was holding a check for a billion dollars…. If you'd have seen me, you would have thought I was loony. A billion dollars." For Branson, it wasn't just the money-it was the thrill of building the business and of seeing the success of his initial idea.

1.3. Characteristics of Successful Entrepreneurs

Although many behaviors have been ascribed to entrepreneurs, several are common to those who are successful. Those in new ventures and those who are already part of an entrepreneurial firm share these qualities, which are shown in Figure 1.1 and described in the following section.

1.3.1. Passion for the Business

The number-one characteristic shared by successful entrepreneurs is a passion for their business, whether it is in the context of a new firm or an

existing business. This passion typically stems from the entrepreneur's belief that the business will positively influence people's lives. Making a difference in people's lives is also the primary motivator behind many social enterprises, which are often started by people who set aside promising careers to pursue a social goal.

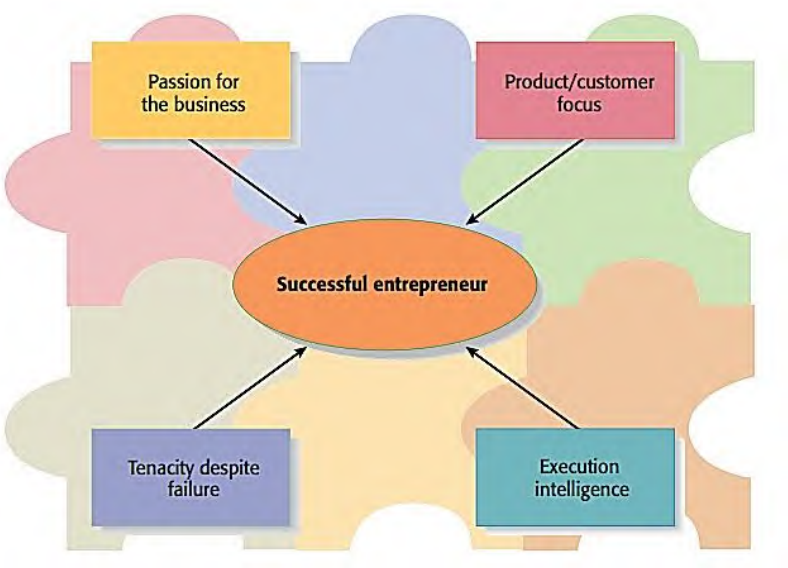

Figure 1.1. Four Primary Characteristics of Successful Entrepreneurs

(Source: Barringer & Ireland, 2016)

A note of caution is in order here: While entrepreneurs should have passion, they should not wear rose-colored glasses. It would be a mistake to believe that all one needs is passion and anything is possible. It is important to be enthusiastic about a business idea, but it is also important to understand its potential flaws and risks. In addition, entrepreneurs should understand that the most effective business ideas take hold when their passion is consistent with their skills and is in an area that represents a legitimate business opportunity.

1.3.2. Product/Customer focus

A second defining characteristic of successful entrepreneurs is a product/ customer focus. This quality is exemplified by Steven Jobs, the late co-founder of Apple Inc., who wrote, "The computer is the most remarkable tool we've ever built … but the most important thing is to get them in the hands of as many people as possible."22 This sentiment underscores an understanding of the two most important elements in any business-products and customers. While it's important to think about management, marketing, finance, and the like, none of those functions makes any difference if a firm does not have good products with the capability to satisfy customers. A product/customer focus also involves the diligence to spot product opportunities and to see them through to completion.

1.3.3. Tenacity despite failure

Because entrepreneurs are typically trying something new, the possibility of failure exists. In addition, the process of developing a new business is somewhat similar to what a scientist experiences in the laboratory. A chemist, for example, typically has to try multiple combinations of chemicals before finding an optimal combination that can accomplish a certain objective. In a similar fashion, developing a new business idea may require a certain degree of experimentation before a success is attained. Setbacks and failures inevitably occur during this process. The litmus test for entrepreneurs is their ability to persevere through setbacks and failures.

1.3.4. Execution intelligence

The ability to fashion a solid idea into a viable business is a key characteristic of successful entrepreneurs. Commonly, this ability is thought of

as execution intelligence.26 In many cases, execution intelligence is the factor that determines whether a start-up is successful or fails. An ancient Chinese saying warns, "To open a business is very easy; to keep it open is very difficult." The ability to effectively execute a business idea means developing a business model, putting together a new venture team, raising money, establishing partnerships, managing finances, leading and motivating employees, and so on. It also demands the ability to translate thought, creativity, and imagination into action and measurable results. As Jeff Bezos, the founder of Amazon.com, once said, "Ideas are easy. It's execution that's hard." For many entrepreneurs, the hardest time is shortly after they launch their firm.

1.4. Common myths about Entrepreneurs

1.4.1. Myth 1: Entrepreneurs are Born, not made

This myth is based on the mistaken belief that some people are genetically predisposed to be entrepreneurs. The consensus of many hundreds of studies on the psychological and sociological makeup of entrepreneurs is that entrepreneurs are not genetically different from other people. This evidence can be interpreted as meaning that no one is "born" to be an entrepreneur and that everyone has the potential to become one. However, there are personality traits and characteristics commonly associated with entrepreneurs, as illustrated in Figure 1.1.

1.4.2. Myth 2: Entrepreneurs are gamblers

A second myth about entrepreneurs is that they are gamblers and take big risks. The truth is, entrepreneurs are usually moderate risk takers, as are most people. The idea that entrepreneurs are gamblers originates from two sources. First, entrepreneurs typically have jobs that are less structured, and so they face a more uncertain set of possibilities than managers or rank-and-file employees. For example, an entrepreneur who starts a social network consulting service has a less stable job than one working for a state governmental agency. Second, many entrepreneurs have a strong need to achieve and often set challenging goals, a behavior that is sometimes equated with risk taking.

1.4.3. Myth 3: Entrepreneurs are motivated primarily by money

It is naive to think that entrepreneurs don't seek financial rewards. As discussed previously, however, money is rarely the primary reason entrepreneurs start new firms and persevere. Some entrepreneurs warn that the pursuit of money can be distracting. Media mogul Ted Turner said, "If you think money is a real big deal … you'll be too scared of losing it to get it."

1.4.4. Myth 4: Entrepreneurs Should Be young and energetic

Entrepreneurial activity is fairly evenly spread out over age ranges. In fact, a sentiment that venture capitalists often express is that they would rather fund a strong entrepreneur with a mediocre business idea than fund a strong business idea and a mediocre entrepreneur. What makes an entrepreneur "strong" in the eyes of an investor is experience in the area of the proposed business, skills and abilities that will help the business, a solid reputation, a track record of success, and passion about the business idea. The first four of these five qualities favor older rather than younger entrepreneurs.

1.4.5. Myth 5: Entrepreneurs love the Spotlight

Indeed, some entrepreneurs are flamboyant; however, the vast majority of them do not attract public attention. In fact, many entrepreneurs, because they are working on proprietary products or services, avoid public notice. These entrepreneurs, like most, have either avoided attention or been passed over by the popular press. They defy the myth that entrepreneurs, more so than other groups in our society, love the spotlight.

1.5. The Positive Effects of Entrepreneurship and Entrepreneurial Firms

Entrepreneurship's importance to an economy and the society in which it resides was expertly articulated in 1934 by Joseph Schumpeter, an Austrian economist who did the majority of his work at Harvard University. In his book The Theory of Economic Development, Schumpeter argued that entrepreneurs develop new products and technologies that over time make current products and technologies obsolete. Schumpeter called this process creative destruction. Because new products and technologies are typically better than those they

replace and the availability of improved products and technologies increases consumer demand, creative destruction stimulates economic activity. The new products and technologies may also increase the productivity of all elements of a society.

1.5.1. Economic impact of entrepreneurial firms

For two reasons, entrepreneurial behavior has a strong impact on an economy's strength and stability.

Innovation: Innovation is the process of creating something new, which is central to the entrepreneurial process. Research shows that small innovative firms are 16 times more productive than large innovative firms in terms of patents per employee. Small firms tend to be particularly innovative in certain industries, as measured by patent activity. For example, small firms account for more than 32 percent of patents in both smart grids and solar energy and 15 percent of patents in batteries and fuel cells.

Job Creation: Small businesses create a substantial number of net new jobs in the United States. Firms with 500 or fewer employees create 65 percent of new jobs on an annual basis, while firms with 50 or fewer employees create 32 percent of new jobs. The only downside of small business jobs is that employee pay tends to be less than is the case in larger companies. Still, small businesses are held in high regard in terms of job creation.

1.5.2. Entrepreneurial firms' impact on Society

Entrepreneurial firms' innovations have a dramatic impact on a society. Think of all the new products and services that make our lives easier, enhance our productivity at work, improve our health, and entertain us.

However, innovations do create moral and ethical issues with which societies are forced to grapple. For example, bar-code scanner technology and the Internet have made it easier for companies to track the purchasing behavior of their customers, a fact that raises privacy concerns. Similarly, bioengineering has made it easier to extend the shelf life of many food products, but some researchers and consumers question the long-term health implications of bioengineered foods.

1.5.3. Entrepreneurial firms' impact on larger firms

In addition to the impact that entrepreneurial firms have on economies and societies, they also positively impact the effectiveness of larger firms. For example, some entrepreneurial firms are original equipment manufacturers, producing parts that go into products that larger firms manufacture and sell. Thus, many exciting new products, such as smartphones, digital cameras, and improved prescription drugs, are not solely the result of the efforts of larger companies with strong brand names, such as Samsung, Apple, and Johnson & Johnson. They were produced with the cutting-edge component parts or research-and-development efforts provided by entrepreneurial firms. The evidence shows that many entrepreneurial firms have built their entire business models around producing products and services that increase the efficiency or effectiveness of larger firms.

Review Questions

1. Do you anticipate that entrepreneurship will continue spreading throughout the world, or do you think its appeal will subside over time?

2. What is entrepreneurship?

3. What are the three primary reasons people become entrepreneurs?

4. Of the three primary reasons people become entrepreneurs, which one is given most commonly and why?

5. What are the four primary traits and characteristics of successful entrepreneurs?

6. Why is passion such an important characteristic of successful entrepreneurs?

7. What are the five common myths of entrepreneurship?

8. In general, what effects does entrepreneurship have on economies and societies throughout the world?

CHAPTER 2: FUNDAMENTALS OF OPPORTUNITY RECOGNIZTION AND IDEA GENERATION

Abstract: The chapter, which is mostly based on the theories developed by Bruce R. Barringer and R. Duane Ireland (2016), presents fundamental content regarding opportunity recognition and idea generation in marketplace. Actually, a real opportunity is considered an invaluable asset which promises entrepreneurs higher possibilities of success than any ideas or diligence. Therefore, the entrepreneurial competence in terms of identifying favorable opportunities is desperately crucial. Accordingly, core attributes of as well as primitive policies to discover business opportunities are largely examined in this chapter. To be specific, the material mentions four key components of what is so-called "a real opportunity", including attractive, durable, timely, and anchored in a valued-added product, service, or business. Meanwhile, the three ways facilitating opportunity identification involve studying environmental trends, addressing a particular problem and detecting business gaps. Also, this material introduces four keen techniques for new idea generation, namely brainstorming, focus groups, Internet research and a collection of other means.

Learning Objectives

By the end of this chapter, students will be able to:

1. Differentiate an opportunity from an idea;
2. Demonstrate three common approaches to identify marketplace opportunities;
3. Define entrepreneurial qualities essential for noticing opportunities;
4. Describe techniques to generate business ideas;
5. Discuss courses of action to encourage constant advancement of entrepreneurial ideas.

Case Study

In September 2018, Amazon company was valued at roughly $1 trillion, as a result, Jeff Bezos, the founder of this giant, has recently become the wealthiest person on earth. According to Bezos, he could not obtain such achievements without having a sharp skill for cultivating ambitious ideas and identifying potential opportunities. Bezos well believes that a differentiated idea instead of a "me too" offering is the first and foremost milestone in the process of establishing his successful business. This billionaire also adds that a mere idea holds a shaky possibility of developing into a moneymaking game. Meanwhile, it is clear that a combination of factors beyond ideas, especially real market demand as well as customers' willingness to pay, bring actual start-up opportunities.

Similarly, it was Da Vinci (1452-1519), the greatest Italian genius in human history, who came up with the idea of flying like birds and created sketches for making a helicopter. However, over four centuries later, in 1903, it was the Wright Brothers, in the United States, who successfully manufactured and conducted the very first flights. Thanks to the Wright Brothers' realization of the flying idea, key problems in travelling distances were significantly solved, which promotes the transportation business using the air space.

Source:

- The Success Story of Jeff Bezos
(https://businessconnectindia.in/success-story-jeff-bezos/)
- https://www.britannica.com/topic/Amazoncom

Question: After studying the above case, could you tell how different an idea is from an opportunity? The answer for this will be discussed in more details below.

https://businessconnectindia.in/success-story-jeff-bezos/

2.1. The Difference between an Opportunity and an Idea

2.1.1. Definition of an Idea and Opportunity

On Collinsdictionary.com, *an Idea* is defined as a thought, plan, scheme, suggestion or course of action that may or may not happen. Accordingly, a *business idea* is like the farming seeds which you hope but are not so sure whether they will grow or how much work and finance it will take to make the seeds a fruitful crop. Normally, an idea is just a product of human innovative minds which might or might not transform into something lucrative. Therefore, multiple business ideas may strike us on a daily basis, only a very small proportion of them will be profitably executed in the long run which are so-called business opportunities.

An Opportunity, on the other hand, refers to a fit, favorable, appropriate or advantageous chance, prospect, or a combination of circumstances that can be utilized to attain something. In other words, *a business opportunity* is a viable and well-researched business idea that appears in the right time and could be potentially converted into a promising venture to generate actual income. Obviously, unless mistaken as ideas, real business opportunities are rare and hard both to identify and exploit efficiently.

While the key to idea generation is the uniqueness and creativity of minds, that of opportunity recognition is to identify and then launch a product or service that a certain market segment will be willing to pay for. Although an opportunity is tough to spot, entrepreneurs are supposed to recognize it timely and turn it into a prosperous business. Besides, entrepreneurs should always bear in mind that not every idea will automatically become an opportunity. Only when there exists a viably favourable combination of essential factors that potentially adds commercial value to an idea should it be seriously considered to be materialised by entrepreneurs.

2.1.2. Components of a Business Opportunity

Both statistical and scientific studies reveal that most entrepreneurial ventures are stimulated from either internal or external ideas when an opportunity is highly available. As soon as an entrepreneur recognizes a

problem or a demand gap, he is supposed to develop a business to address that problem or fill the specified gap. Regardless of which way an entrepreneur starts his business, sighting a positive business opportunity among hundreds or even thousands of available products is desperately challenging. A common mistake entrepreneurs make in the opportunity recognition process is picking an existing product or service matching their passionate ideas and then trying to build a business around a slightly better version of it. Although this approach seems sensible, the venture could be much affirmed if the identified opportunity has four essential qualities as follows:

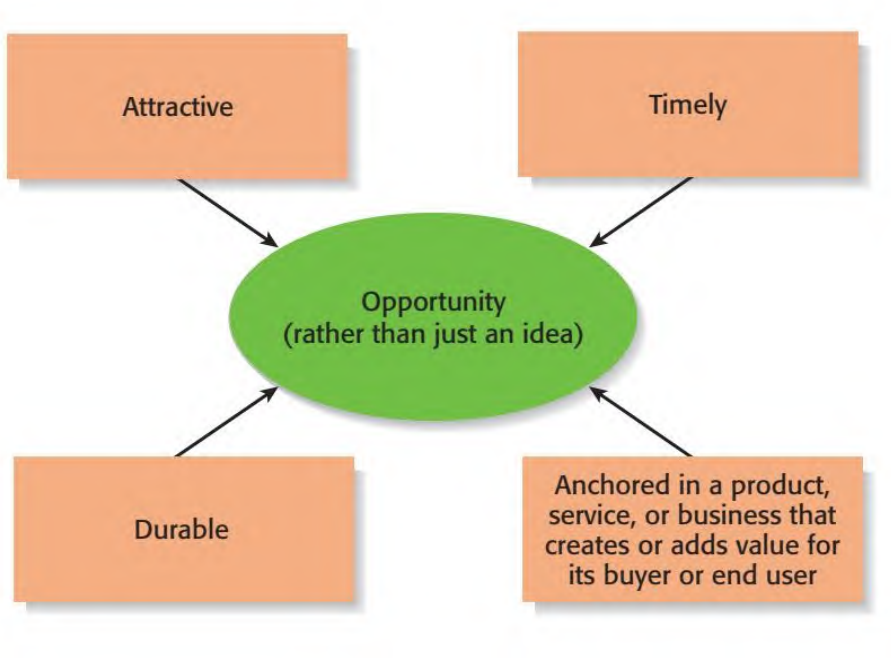
Attractive
Timely
Opportunity
(rather than just an idea)
Durable
Anchored in a product, service, or business that creates or adds value for its buyer or end user

Figure 2.1: Four core components of an Opportunity

(Source: Barringer & Ireland, 2016)

+) *First*, the opportunity has to be attractive: there is a highly potential market for the start-up's products or service which will generate on-going revenue for entrepreneurs.

+) *Second*, the opportunity has to be durable: entrepreneurs should be alert and sensible to clearly differentiate real and long-lived market demand from fads.

+) *Third*, it is crucial for the opportunity to be recognized timely: entrepreneurs need to launch their businesses at the right time, whether too early or too late is inappropriate.

+) *Last but not least*, the opportunity could be converted into products or services that produce or add value for buyers.

Normally, an idea will be deemed unattractive and unlikely to be transformed into a desirable opportunity if any of the four components are absent. Global surveys reveal that an entrepreneur only decides to capitalize on an opportunity upon witnessing that the *window of opportunity* is open. The term *window of opportunity* represents the appropriate time period for a business to realistically enter a new market. Once the market for a new product is viable, its window of opportunity opens. At some later point after the growth stage, the market becomes mature and the window of opportunity will gradually close together with the decline in sales or the number of buyers.

2.1.3. The Difference between an Opportunity and an Idea

It is highly critical for entrepreneurs to fully aware of the difference between an opportunity and an idea in order to operate efficiently. Below are summary of what normally differentiate an opportunity from its counterpart.

+) An idea is a creative thought, impression, or notion that could be used to make money but may not meet the criteria of an opportunity.

+) Only a well-researched and highly feasible idea bears the potential to become a real opportunity.

+) An Opportunity usually has proven commercial value, which encourages investors to invest their money in; meanwhile, despite consisting of inspiration and originality, very often an idea is not backed by investors.

Obviously, thorough understanding of the difference between an idea and an opportunity is of significant importance for entrepreneurs to avoid risking resources. Also, it is crucial to create and discover the favourable conditions that help translate an idea into an actual opportunity. According to Vogel (2016), the framework in which a viable opportunity is formed based on the feasibility assessment of a relevant idea can be presented as follows:

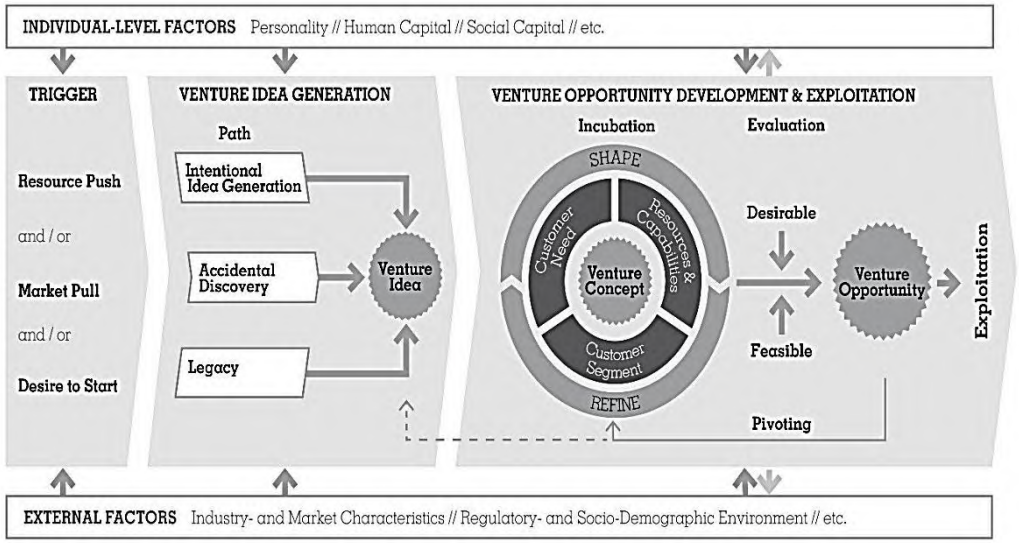

Figure 2.2: Principles to turn an idea into an opportunity

(Source: Peter Vogel, 2016)

As can be seen from the chart, following the analogy of seeding, an intensive investment of time, effort and multi-resources is required in order to make an initial idea a profitable business opportunity. Below are leading recommended principles:

(i) Even a desirable idea need testing seriously multiple times to make sure it works and fits the target marketplace. In the meantime, appropriate adaptations and modifications are supposed to be made.

(ii) It will cost time, effort and resources to transform an idea into a real opportunity. Certainly, there may be the presence of ups and downs accompanied in the entrepreneurial journey.

An example for this differentiation would be the consideration of whether to implement the idea of screening movies for dinners at a restaurant. For many people, this idea sounds interesting with high probability of entertaining customers, which as a result, may promise a lucrative additional profit for the restaurant. However, to make it a business opportunity, significant research and introspection is required, particularly to figure out the willingness to pay of potential customers. Unless a conceivable demand is

viable in the target market, there is little room to translate the given idea into a real opportunity.

2.2. Personal Characteristics of Entrepreneurs

Scientists have noticed a couple of personal qualities that tend to make some people better at recognizing opportunities than others, among those are four as follows:

2.2.1. Prior Experience

Several studies prove that prior experience including skills and expertise in an industry strongly assists entrepreneurs to recognize business opportunities. Obvious, having information, acquaintances as well as expertise of the target industry is of grand significance for entrepreneurs to effectively identify potential opportunities. Specifically, thanks to experience in a relevant industry, it is often more likely for an individual to spot an underserved niche market. Similarly, recent research has affirmed the importance of prior experience in terms of enhancing business survival and performance. Moreover, working time in a particular area brings an individual a desirable network of both professional and social contacts which may lead to insightful opportunities.

2.2.2. Cognitive Factors

Whether opportunity recognition is an innate skill or a cognitive process has been a heated controversy, however, a considerable proportion of people lay their trust on the latter. Accordingly, these advocates believe that successful entrepreneurs are bestowed with the "sixth sense" which allows them to perceive the opportunities that others miss. This extra sense, which is known as entrepreneurial alertness, is formally defined as the ability to notice things without engaging in deliberate search or observation.

2.2.3. Social Networks

The scale and scope of an individual's social network is widely believed to exert certain influence on his/her capability to identify opportunities. To be specific, entrepreneurs with larger social networks prove to be particularly sensitive in terms of opportunity recognition on encountering compared to

those who prefer to work on their own. A crucial notion that sheds light on the role of social networks towards opportunity recognition is that entrepreneurs are more likely to come up with business ideas and opportunities through weak-tie rather than strong-tie. Strong-tie refers to the relationships with frequent interactions between close acquaintances like colleagues, peers and spouses; meanwhile the other is characterized by occasional interactions with casual contacts. It is widely believed that there is no better way to enter and flourish in a market than through contacts. Therefore, entrepreneurs are highly supposed to leverage their social networks in order to gain market advantages.

2.2.4. Creativity

The entrepreneurs' alertness in terms of identifying opportunities is supposed to closely related to the creativity process. At individual level, the creative process can be broken down into five successive phases: (i) Preparation - refers to an entrepreneur's background, experience, and knowledge that could be applied in the opportunity recognition process; (ii) Incubation - represents the stage during which a person considers an idea or thinks about a problem; (iii) Insight - happens when an entrepreneur comes up with a highly potential idea or solutions for an identified problem; (iv) Evaluation - is the stage of analyzing feasibility of the chosen idea and (v) Elaboration - involves the step of materializing the creative idea.

2.3. Three Ways to Identify Opportunities

2.3.1. Observing Trends

Observing integrated trends is one among the three approaches that help entrepreneurs to identify and create opportunities. The integrated trends refer to the external and internal factors which may exert impact on business operation, including economic, social, technological and political trends. It is essential for an entrepreneur to stay highly aware and updated of changes in these areas. Michael Yang, the founder of Become.com, firmly cited keen observation ability and sensitive reactions to changes of environmental trends are key attributes of successful entrepreneurs. Also, this businessman further explained that acute observation skills not only offer entrepreneur delicate understanding

of current needs, encourage them to generate original ideas but enable them to anticipate trends as well.

When studying environmental trends in relation to business ideas, the following points should be taken into consideration: (i) a trend is largely different from a fad in many aspects. Typically, it is risky for a start-up to pursue a fad which requires considerable resources to satisfy temperament demand; (ii) trends are closely interconnected and should be considered simultaneously in the process of brainstorming new business ideas.

In general, an entrepreneur ought to study a combination of four major environmental trends (Fig. 2.3), including *Economic Forces, Social Forces, Technological Advances* and *Political Changes*, in order to generate new ideas and possible solutions or identify business opportunities.

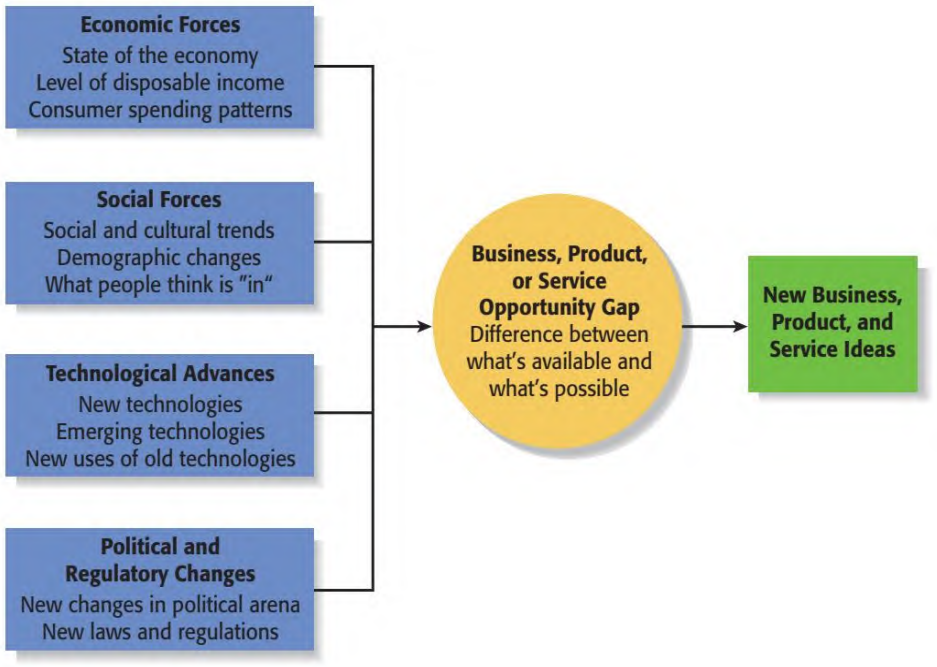

Figure 2.3: Environmental Trends for Entrepreneurial Considerations

(Source: Barringer & Ireland, 2016)

• *Economic Forces:* It is vital for an entrepreneur to obtain thorough perception of economic trends in order to make right business decisions in

different situations. Normally, customers in a healthy economy are willing to pay for a variety of products and services; meanwhile, when the economy is weak, people are more reluctant to spend their money on even essential goods. However, a weak economy is reckoned to create opportunities for start-ups, especially those specializing in finance-saving solutions. Therefore, studying of economic forces provides entrepreneurs with insightful understanding of potential customers and products. For example, the Covid19 pandemic is supposed to provoke the mounting increase in the demand for virtual training courses in Vietnam, which has opened ample opportunities for education dot coms. Similarly, witnessing the excessive demand for medical hygiene masks around globe, TNG Investment and Trading JSC company (Thai Nguyen province) decided to prioritize the production of masks for export, which has gained this company significant revenue. (e.g. of areas to avoid)

- *Social Forces*: apprehension of how social forces affect business ideas plays an important role in the opportunity recognition process. Generally, a product or service is developed for the reason of meeting a certain social need more than the transparent need it is supposed to fill. For instance, it is the human demand for networking and communicating with each other which triggers the booming popularity of social sites like Facebook or Instagram. For the same token, the widespread growth of fast-food business is not simply because of people's delight in this kind of food, but rather because of the fact that many people are too busy to prepare their own meals. Obviously, alteration in social trends will change normal people's behavior, which accordingly may affect the operation of certain areas while producing catalyst for new business ideas. The following social trends are cited to act as effective platforms for highly potential business ideas in the coming future:
  - Aging population
  - More diverse workforce
  - Increasing popularity of smartphones and social networks
  - Intensive concern about health and wellness
- *Technological Advances:* Advancement in technology is verified to produce opportunities assisting people's performance in a more efficient way.

For example, Traveloka.com, a Jakarta-based unicorn company established in 2012, is a prevailing website that provides airline ticketing and hotel booking services online. In the beginning, Traveloka served as a search engine to compare the price of airline tickets from various other sites for ultimate flight reservation; recently it has expanded to provide lifestyle products and services such as attraction tickets, activities, car rental, and restaurant vouchers. This successful dot com was founded by information technology practitioners and is now widely active in the Southeast Asia and Australia, enabling people's transactions in a more convenient and expedient manner. Also, it should be noted that as a new technology is developed, new products or service often emerge to advance it. For example, the creation of iPhone, iPad and similar devices has given rise to the appearance of related industries that produce compatible accessories.

• *Political Changes:* For sure, changes in the regulatory system may either hinder or promote the realization of business ideas and opportunities. Sometimes, a new law that is favorable to certain industry, thus, fostering start-ups in this area, may be considered a substantial barrier in other sectors. Understandably, in the context of instable politics or under the threat of terrorism, people will become increasingly concerned about security-intensive products and services. For example, multimedia data backup service is believed to hugely expand in Vietnam in coming years after the proliferation of the Cybersecurity. Accordingly, a number of IT professionals have recently been well paid to rescue the hacked Facebook accounts of celebrities and individuals.

2.3.2. Solving a Problem

Finding solutions for existing problems is another approach to identify opportunities. Problems may come from all life corners at various levels of complication ranging from the broken screen of a favourite smartphone, the English translation for a doctorate dissertation on medicine to tracing family origins. Sensitive observation of such issues as well as generation of possible fixing measures can set a favourable platform for recognizing a business opportunity. Technology advancement usually causes problems for certain

groups of people, particularly the elderly or disabled. For instance, several aged people find modern cells unfriendly with tiny buttons which makes it hard for them to both compose and read a text. To solve this issue, GreatCall.Inc decided to produce Jitterbug, specifically designed for elderly users. The Jitterbug is characterized by a large keypad which facilitates dialing and texting functions. Another example is SafetyWeb which has created a Web-based service allowing parental control on their children's internet usage. Similarly, many companies have emerged to solve the problem of disconnection on mobile phone due to out-of-charge.

2.3.3. Finding Gaps in the Marketplace

Obviously, product and service gaps in the marketplace promise highly potential business opportunities. Entrepreneurs with sharp skills of identifying such gaps will greatly benefit from providing products and services meeting the unmet demand. This explains the prevailing existence of niche boutiques both in form of street shops and e-commerce websites which helps fulfil the demand for brand clothes of high-income but desperately busy customers. Similarly, Tish Cirovolo was started as its entrepreneurs realized the potential the market segment for just-for-women guitars. For the same token, Southpaw Guitars (in Houston, Texas) has decided to specialize in satisfying the demand for guitars of left-handed players. Commonly, marketplace gaps emerge when the demand for a particular product or service of certain customer groups has not been accommodated. This is actually the scenario for the establishment and successful operation of Bodacious, a store selling stylish clothing of extra size for people with abnormal body changes such as after serious illness or post pregnancy. Another gap-related technique for generating new business opportunities is to position a quite different target market by modifying an existing product. This approach desperately emphasizes the involvement of gap creation and fulfilment.

Case Study: The success of TH Milk group & Vinfast company

The demand for milk in Vietnamese market has witnessed remarkable growth since the 1990s, together with which is the flourish of milk powder imports. In this context, in 2001, the Government launched a national dairy

development program based on the diffusion of small-scale household farming. Thanks to this timely action, during 2001-2010 period, the milk production was multiplied by 5 while the average annual consumption of dairy products in Vietnam also rose from 1 to 16 kg per person. However, by the end of 2008, the high dependency on milk powder imports proved serious impact during the "Melamine crisis". To respond, a new National Livestock Development Strategy was introduced with priority given to large-scale family farming. Following this new policy, in 2010, one of the world's biggest dairy farms owned by TH group started its intensive and large-scale production in Vietnam. The Asian Book of Records reckons TH Milk group as the largest concentrated and high-tech dairy farm in Asia which holds high potential of becoming Vietnam's leading manufacturer of dairy products in the near future. According to researchers and experts, the great success secret of TH Milk group in Vietnamese market lies in its overall strategy of making true natural milk without using any powder milk.

(Source: *www.thmilk.vn*)

Over the last decades, Vingroup has established its position as Vietnam's largest private enterprise, a market leader as well as a trusted brand in diverse fields. With the hope for a better life for Vietnamese citizens, Vingroup had always wanted to build a proud car brand for the domestic market. Therefore, in mid-2017, Vinfast was established to realize Vingroup's vision towards creating national cars with a strong Vietnamese identity. Actually, low-cost battery exchange at customers' convenience is believed to be the unique selling point of VinFast automobiles compared to current foreign rivals in Vietnamese market. Representing a desire to establish a modern, high-tech vehicle brand in Vietnam, VinFast is expected to well contribute to the country's strategic goal of industrialization and modernization. Understandably, Vinfast has received substantial support with frequent presences of government leaders at the company's public events. According to LMC Automotive, VinFast is enjoying a 50% cut in corporate income tax for 15 years and a 50% personal income tax break for its employees. VinFast, with its increasing localization rate in line with a synchronous and complete production cycle is hoped to well represent

the country and be highly competitive on the global automobile stage in the coming years.

(Source: *www.vingroup.net*)

2.4. Techniques for Generating Ideas

Normally, it is more usual for entrepreneurs to identify ideas than opportunities since only few great ideas would be successfully capitalized to become potential opportunities. This section focuses on common techniques which facilitate the stimulation and generation of business ideas.

2.4.1. Brainstorming

"Brainstorming walls" or "Critical thinking corner" have recently been available in several companies as the space for staff to freely note down their ideas and recommendations. With this, people can stand back, jotting down and viewing hundreds of ideas simultaneously as well as making possible connections that they would not otherwise have come up with. So, what is brainstorming and how to conduct this technique effectively in the field of business? In general, brainstorming represents the process of initiating different ideas on a given topic. This process, hence, may involve the cognitive session of an individual or a group of people. Productive brainstorming ought to strictly follow what is so-called the "welcoming rule" where no criticism in any forms is supposed to be present as this may badly deter originality and accordingly hinder the free flow of ideas. Also, it is important to understand that an individual's creativity is the only limit in the brainstorming process. In fact, mind-mapping or *bug report* completion is among popular techniques to teach and practice brainstorming.

2.4.2. Focus Groups

Focus group technique can be used for a number of purposes, including the breeding of business ideas. In general, a focus group is a small gathering of people (often between 5 and 10) who share the same issue or interest in certain aspects. Typically, focus groups involve group discussion in which responses and solutions for the given questions are generated. This technique is believed to work best under the control of trained facilitators and when a basket of

business ideas has been formulated. Usually, the moderator's tactics in making focused questions as well as keeping the group discussion on track will determine much of the productiveness of a focus group session. This is actually what retailers like Starbucks often conduct to discover product gaps or solutions for existing issues. Usually, the targeted information associated with focus groups include the specifically customized dimensions such as the color and design or the points of selling. Thanks to effective group discussions, entrepreneurs may come up with ideas about new product lines or relevant improvements to their existing service to better satisfy their customers.

2.4.3. Library and Internet Research

Library and Internet research has long been considered significant way to generate new business ideas and even identify great business opportunities. In other words, an entrepreneur can take full good advantage of technology advances as well as others' thoughts to serve his business aim. Simply browsing libraries' various documents ranging from science articles, commerce journals to industries' review or corporate reports may help initiate several new ideas. In addition, giant search engines and databases on the Internet also provide useful materials for idea generation. For instance, within a click, you will be presented with pages of links to newspapers and journal papers about the latest new business ideas by simply entering the phrase "new business ideas" into Google. Writer Victor Hugo once said "the best way to have a good idea is to have a lot of ideas", therefore, library and internet search efficiently serve as a great starting point to generate new ideas.

In fact, a company often conducts a number of other techniques to produce ideas in addition to those mentioned above. Customer advisory boards or anthropological research is among common approaches applied to discover customers' needs, wants, complaints and desires, which potentially results in relevant solutions or business ideas.

Review Questions

1.How is an idea different from an opportunity?

2. What are the components of a business opportunity?

3. How to transform an idea into an actual opportunity?

4. What are common qualities of an entrepreneur?

5. Discuss key environmental trends to identify business opportunities.

6. Complete below sentences with suitable words from the chapter:

a. Being _____, which emphasizes market's real and long-lived demand for certain products or services, is among key components of a business opportunity.

b. Entrepreneurs with _____ experience in an industry are often better at recognizing opportunities in that area.

c. Wise investors normally decide to _____ real business opportunities rather than ambitious ideas.

d. The scale and scope of an entrepreneur's _____ _____ whether strong-tie or weak-tie may exert significant influence on his/her capability to identify opportunities.

e. Aging population is among _____ trends cited to act as effective platforms for highly potential business ideas in the coming future.

f. Finding _____ in the marketplace is a crucial approach to identify business opportunities.

CHAPTER 3: FEASIBILITY ANALYSIS AND ENTREPRENEURSHIP

Abstract: Chapter 3 provides introductory overview about feasibility analysis. Students are expected to understand the importance of feasibility analysis, from perspectives of product/service feasibility analysis and industry/market feasibility analysis. This chapter describes organizational feasibility analysis and financial feasibility analysis, along with two primary issues to consider when completing these analysis. A feasibility analysis template is presented to furnish students with practical tool for feasibility analysis.

Learning Objectives

By the end of this chapter, students will be able to:

1. Explain what a feasibility analysis is and why it's important.

2. Describe a product/service feasibility analysis, explain its purpose, and discuss the two primary issues that a proposed business should consider in this area.

3. Describe an industry/market feasibility analysis, explain its purpose, and discuss the two primary issues to consider when completing this analysis.

4. Explain what an organizational feasibility analysis is and its purpose and discuss the two primary issues to consider when completing this analysis.

5. Describe what a financial feasibility analysis is, explain its importance, and discuss the most critical issues to consider when completing this analysis.

6. Describe a feasibility analysis template and explain why it is important for entrepreneurs to use this template.

3.1. Feasibility Analysis

Feasibility analysis is the process of determining if a business idea is viable (see Figure 3.1). If a business idea falls short on one or more of the four components of feasibility analysis, it should be dropped or rethought, as shown in the figure. Many entrepreneurs make the mistake of identifying a business idea and then jumping directly to developing a business model to describe and gain support for the idea. This sequence often omits or provides little time for the important step of testing the feasibility of a business idea.

A mental transition must be made when completing a feasibility analysis from thinking of a business idea as just an idea to thinking of it as a business. A feasibility analysis is an assessment of a potential business rather than strict product or service idea. The sequential nature of the steps shown in Figure cleanly separates the investigative portion of thinking through the merits of a business idea from the planning and selling portion of the process. Feasibility analysis is investigative in nature and is designed to critique the merits of a proposed business.

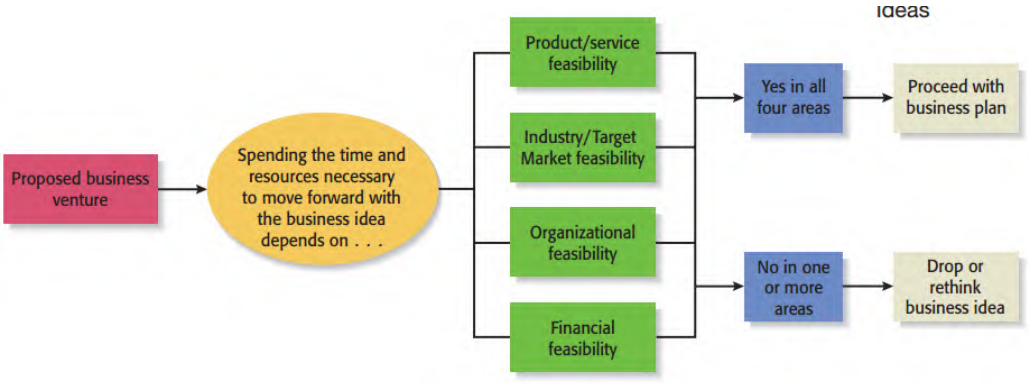
Ideas
Proposed business venture
Spending the time and resources necessary to move forward with the business idea depends on . . .
Product/service feasibility
Industry/Target Market feasibility
Organizational feasibility
Financial feasibility
Yes in all four areas
Proceed with business plan
No in one or more areas
Drop or rethink business idea

Figure 3.1. Role of Feasibility Analysis in Developing Successful Business Ideas

(Source: Barringer & Ireland, 2016)

Completing a feasibility analysis requires both primary and secondary research. Primary research is research that is collected by the person or persons completing the analysis. It normally includes talking to prospective customers,

getting feedback from industry experts, conducting focus groups, and administering surveys. Secondary research probes data that is already collected.

It should be emphasized that while a feasibility analysis tests the merits of a specific idea, it allows ample opportunity for the idea to be revised, altered, and changed as a result of the feedback that is obtained and the analysis that is conducted. The key objective behind feasibility analysis is to put an idea to the test-by eliciting feedback from potential customers, talking to industry experts, studying industry trends, thinking through the financials, and scrutinizing it in other ways. These types of activities not only help determine whether an idea is feasible but also help shape and mold the idea.

3.2. Product/Service Feasibility Analysis

Product/service feasibility analysis is an assessment of the overall appeal of the product or service being proposed. Although there are many important things to consider when launching a new venture, nothing else matters if the product or service itself doesn't sell. There are two components to product/service feasibility analysis: product/service desirability and product/service demand.

3.2.1. Product/Service desirability

The first component of product/service feasibility is to affirm that the proposed product or service is desirable and serves a need in the marketplace.

You should ask yourself, and others, the following questions to determine the basic appeal of the product or service:

- Does it make sense? Is it reasonable? Is it something real customers will buy?
- Does it take advantage of an environmental trend, solve a problem, or fill a gap in the marketplace?
- Is this a good time to introduce the product or service to the market?
- Are there any fatal flaws in the product or service's basic design or concept?

The proper mind-set at the feasibility analysis stage is to get a general sense of the answers to these and similar questions, rather than to try to reach

final conclusions. The best way to achieve this is to "get out of the building" and talk to potential customers. This sentiment is the primary mantra of the lean startup movement. A tool that is particularly useful in soliciting feedback and advice from prospective customers is to administer a concept test.

Concept Test: A concept test involves showing a preliminary description of a product or service idea, called a concept statement, to industry experts and prospective customers to solicit their feedback. It is a one-page document that normally includes the following:

- A description of the product or service. This section details the features of the product or service; many include a sketch of it as well.
- The intended target market. This section lists the consumers or businesses who are expected to buy the product or service.
- The benefits of the product or service. This section describes the benefits of the product or service and includes an account of how the product or service adds value and/or solves a problem.
- A description of how the product or service will be positioned relative to competitors. A company's position describes how its product or service is situated relative to its rivals.
- A brief description of the company's management team.

After the concept statement is developed, it should be shown to at least 20 people who are familiar with the industry that the firm plans to enter and who can provide informed feedback. The temptation to show it to family members and friends should be avoided because these people are predisposed to give positive feedback. Instead, it should be distributed to people who will provide candid and informed feedback and advice.

3.2.2. Product/Service demand

The second component of product/service feasibility analysis is to determine if there is demand for the product or service. Three commonly utilized methods for doing this include (1) talking face-to-face with potential customers, (2) utilizing online tools, such as Google Adwords and landing pages, to assess demand, and (3) library, Internet, and gumshoe research.

Talking Face-to-Face with Potential Customers: The only way to know if your product or service is what people want is by talking to them. Curiously, this often doesn't happen. One study of 120 business founders revealed that more than half fully developed their products without getting feedback from potential buyers.4 In hindsight, most viewed it as a mistake. The authors of the study quoted one of the participants as saying "You'll learn more from talking to five customers than you will from hours of market research (at a computer)."

The idea is to gauge customer reaction to the general concept of what you want to sell. Entrepreneurs are often surprised to find out that a product idea that they think solves a compelling problem gets a lukewarm reception when they talk to actual customers.

In some instances, you have to pause and think carefully about who the potential customer is. For example, in health care the "customer" is typically not the patient who will use the drugs or benefit from a medical procedure. Instead the actual customer, or the entity that will be paying the bill, is often an insurance company and hospital. You should also talk to as many of the relevant players in an industry as possible. Sometimes this involves a complex list of people, but it is necessary to fully vet the initial feasibility of an idea.

Table 3.1. Categories of people to talk to as part of product/servic Feasibility analysis for a new type of Home Health Care service

Category of people to talk to
1. Potential users of the service
2. Family members of potential users of the service
3. Physicians
4. Nurses
5. Health insurance companies
6. Pharmaceutical companies
7. owners/managers of assisted living facilities and nursing homes
8. Hospital and physician office administrators
9. Founders of other companies in the home health care industry

(Source: Barringer & Ireland, 2016)

Utilizing Online Tools, Such as google adWords and landing Pages, to assess Demand: Another common approach to assessing product demand is to use online tools, such as Google AdWords and landing pages. Conducting keyword research will tell you what consumers are searching for all over the world. If no one is looking for what you want to sell, that's not a good sign. On the other hand, if thousands of searches are being done for keywords closely related to your product, you might want to take the next step sooner rather than later.

Normally, utilizing an AdWords and landing page campaign wouldn't be the only thing you'd do to assess demand. You'd still want to talk to prospective customers face-to-face, as discussed earlier. Running an AdWords and landing page campaign is, however, a practical and often surprisingly affordable way to get another data point in regard to assessing demand for a new product or service idea.

Library, internet, and gumshoe research: The third way to assess demand for a product or service idea is by conducting library, Internet, and gumshoe research. While talking to prospective customers is critical, collecting secondary data on an industry is also helpful.

3.3. Industry/Target Market Feasibility Analysis

Industry/target market feasibility is an assessment of the overall appeal of the industry and the target market for the product or service being proposed. There is a distinct difference between a firm's industry and its target market; having a clear understanding of this difference is important. An **industry** is a group of firms producing a similar product or service, such as computers, children's toys, airplanes, or social networks. A firm's **target market** is the limited portion of the industry that it goes after or to which it wants to appeal. Most firms, and certainly entrepreneurial start-ups, typically do not try to service an entire industry. Instead, they select or carve out a specific target market and try to service that group of customers particularly well.

There are two components to industry/target market feasibility analysis: industry attractiveness and target market attractiveness.

3.3.1. Industry Attractiveness

Industries vary in terms of their overall attractiveness. In general, the most attractive industries have the characteristics depicted in Table 3.2. The top three factors are particularly important. Industries that are young rather than old, are early rather than late in their life cycle, and are fragmented rather than concentrated are more receptive to new entrants than industries with the opposite characteristics. You also want to pick an industry that is structurally attractive-meaning start-ups can enter the industry (in various target markets) and compete effectively. Some industries are characterized by such high barriers to entry or the presence of one or two dominant players that potential new entrants are essentially shut out.

Table 3.2. Characteristics of attractive industries

• Are young rather than old
• Are early rather than late in their life cycle
• Are fragmented rather than concentrated
• Are growing rather than shrinking
• Are selling products or services that customers "must have" rather than "want to have"
• Are not crowded
• Have high rather than low operating margins
• Are not highly dependent on the historically low price of a key raw material, like gasoline or flour, to remain profitable

(Source: Barringer & Ireland, 2016)

3.3.2. Target Market Attractiveness

We noted previously that a target market is a place within a larger market segment that represents a narrower group of customers with similar needs. Most start-ups simply don't have the resources needed to participate in a broad market, at least initially. Instead, by focusing on a smaller target market, a firm can usually avoid head-to-head competition with industry leaders and can focus on serving a specialized market very well. It's also not realistic, in most cases, for a

start-up to introduce a completely original product idea into a completely new market. In most instances, it's just too expensive to be a pioneer in each area.

3.4. Organizational Feasibility Analysis

Organizational feasibility analysis is conducted to determine whether a proposed business has sufficient management expertise, organizational competence, and resources to successfully launch. There are two primary issues to consider in this area: management prowess and resource sufficiency.

3.4.1. Management prowess

A proposed business should evaluate the prowess, or ability, of its initial management team, whether it is a sole entrepreneur or a larger group. This task requires the individuals starting the firm to be honest and candid in their self-assessments. Two of the most important factors in this area are the passion that the solo entrepreneur or the management team has for the business idea and the extent to which the management team or solo entrepreneur understands the markets in which the firm will participate.

A collection of additional factors help define management prowess. Managers with extensive professional and social networks have an advantage in that they are able to reach out to colleagues and friends to help them plug experience or knowledge gaps. In addition, a potential new venture should have an idea of the type of new-venture team that it can assemble. **A new-venture team** is the group of founders, key employees, and advisers that either manage or help manage a new business in its start-up years. If the founder or founders of a new venture have identified several individuals they believe will join the firm after it is launched and these individuals are highly capable, that knowledge lends credibility to the organizational feasibility of the potential venture. The same rationale applies for highly capable people a new venture believes would be willing to join its board of directors or board of advisers.

3.4.2. Resource Sufficiency

The second area of organizational feasibility analysis is to determine whether the proposed venture has or is capable of obtaining sufficient resources to move forward. The focus in organizational feasibility analysis is

on nonfinancial resources. The objective is to identify the most important nonfinancial resources and assess their availability. An example is a start-up that will require employees with specialized skills. If a firm launches in a community that does not have a labor pool that includes people with the skill sets the firm needs, a serious resources sufficiency problem exists.

3.5. Financial Feasibility Analysis

Financial feasibility analysis is the final component of a comprehensive feasibility analysis. For feasibility analysis, a preliminary financial assessment is usually sufficient; indeed, additional rigor at this point is typically not required because the specifics of the business will inevitably evolve, making it impractical to spend a lot of time early on preparing detailed financial forecasts. The most important issues to consider at this stage are total start-up cash needed, financial performance of similar businesses, and the overall financial attractiveness of the proposed venture.

3.5.1. Total Start-up cash needed

This first issue refers to the total cash needed to prepare the business to make its first sale. An actual budget should be prepared that lists all the anticipated capital purchases and operating expenses needed to get the business up and running. After determining a total figure, an explanation of where the money will come from should be provided. Avoid cursory explanations such as "I plan to bring investors on board" or "I'll borrow the money." Although you may ultimately involve investors or lenders in your business, a more thoughtful account is required of how you'll provide for your initial cash needs.

3.5.2. Financial performance of Similar businesses

The second component of financial feasibility analysis is estimating a proposed start-up's potential financial performance by comparing it to similar, already established businesses. Obviously, this effort will result in approximate rather than exact numbers. There are several ways of doing this, all of which involve a little gumshoe labor. First, substantial archival data, which offers detailed financial reports on thousands of individual firms, is available online. There are additional ways to obtain financial data on smaller firms. If a start-up

entrepreneur identifies a business that is similar to the one he or she wants to start, and the business isn't likely to be a direct competitor, it's perfectly acceptable to ask the owner or manager of the business to share sales and income data. Even if the owner or manager is only willing to talk in general terms, that information is certainly better than nothing. Simple observation and legwork is a final way to obtain sales data for similar businesses. This approach is suitable in some cases and in others it isn't. For example, if you were proposing to open a new smoothie shop, you could gauge the type of sales to expect by estimating the number of people who patronize similar smoothie shops in your area, along with the average purchase per visit. A very basic way to do this is to frequent these stores and count the number of customers who come in and out of the stores during various times of the day.

3.5.3. Overall Financial Attractiveness of the proposed venture

A number of other factors are associated with evaluating the financial attractiveness of a proposed venture. These evaluations are based primarily on a new venture's projected sales and rate of return (or profitability), as just discussed. At the feasibility analysis stage, the projected return is a judgment call. A more precise estimation can be computed by preparing pro forma (or projected) financial statements, including one- to three-year pro forma statements of cash flow, income statements, and balance sheets (along with accompanying financial ratios). This work can be done if time and circumstances allow, but is typically done at the business plan stage rather than the feasibility analysis stage of a new venture's development. To gain perspective, a start-up's projected rate of return should be weighed against the following factors to assess whether the venture is financially feasible:

- The amount of capital invested
- The risks assumed in launching the business
- The existing alternatives for the money being invested
- The existing alternatives for the entrepreneur's time and efforts

Review Questions

1. How would you describe the four areas that a properly executed feasibility analysis explores?

2. What is a product/service feasibility analysis?

3. What are the two ways that entrepreneurs assess the likely product demand for the proposed product or service they are analyzing?

4. What are the attributes or characteristics of an attractive industry for a new venture?

5. What is a target market?

6. Why do most start-ups focus on relatively small target markets to begin with rather than larger markets with more substantial demand?

7. What is an organizational feasibility analysis?

8. What is a new venture team?

9. What is a financial feasibility analysis?

10. What are the three separate components of financial feasibility analysis?

CHAPTER 4:
BUSINESS MODEL FOR ENTREPRENEURSHIP

Abstract: In this chapter, the business models and their importance will be discussed firstly. Then, we describe a pattern for developing the business model, namely the Barringer/Irish Business Model Template. This model provides a general outline of the elements of a company's business model, which comprises 4 categories and 12 items. An important principle similar to the feasibility analysis is that the business model of the company should not be completed in isolation. Company founders should "get out of the building" and talk to potential customers as the company's business model takes shape. This is the aspect of developing an effective business model that we emphasize throughout the chapter.

Learning objectives

By the end of this chapter, students will be able to:

1. Describe business models and discuss their importance.

2. Distinguish and explain the two general types of business models-standard and disruptive business models.

3. Explain the components of the Barringer/Ireland Business Model Template which entrepreneurs may apply to develop a business model for their firm.

Sendo (Sendo.vn): A miracle of Vietnamese e-commerce platform

As a country with the highest e-commerce growth rate in Southeast Asia, the Vietnamese market has seen many names disappeared in the race for market share. Interestingly, a Vietnamese e-commerce platform-Sendo has still existed and thrived for many years.

In September 2012, Sendo.vn ecommerce floor was establishes, originally a project under FPT Corporation. After more than 8 years, Sendo is currently one of the leading e-commerce floors in Vietnam, serving more than 10 million customers with 300,000 sellers nationwide. Sendo is a domestic name with outstanding growth, ranking 6th in the top 10 of e-commerce exchanges in Southeast Asia (according to iPrice). Sendo is also admitted by large shipping companies in Vietnam such as ViettelPost, VNPost, GHN… in terms of scale.

What makes Sendo successful is its choice of a different business model. Mr Tran Hai Linh - General Director of Sendo shared that: "2012 was the time when the internet was booming in Vietnam, this was an opportunity for e-commerce to develop, contributing to the wide spread of goods. At that time, we studied a lot of business models of India, Indonesia, America… and decided to start an e-commerce business. With expertise in technology, the first developers taught themselves and built the Sendo platform day by day with support from FPT and SBI. Moreover, e-commerce companies such as Lazada, Shoppee, Lotte or emerging "startups" like Adayroi and Tiki all wanted to "jump" into the big market in Ho Chi Minh City or Hanoi. Therefore, while others chose to invest in warehouse and transportation teams, Sendo chose to bring Customer to Customer model (C2C model) to rural people, which created stronger revenue growth for Sendo. Sendo did not invest in warehouse but could cooperate with units that have advantages in professional warehouse to serve customers. Recently, in an interview, Mr Linh also affirmed that: "C2C was a suitable business model at the time Sendo was established. We could have a lot of goods in a short time with low demand for service quality at that time. However, the market have developed over time, the service standards and goods also increase. It is hard to say which model we will choose in the future. In the short term, it can only be said that Sendo will continuously refine existing models as with current C2C. Sendo does not need too many sellers, it needs qualified sellers. The chosen standards are stricter and the control of commodity information is also more accurate, supported by the self-learning of the system. Accordingly, Sendo intends to provide a platform for networking and business on our community of users. Last year, we launched SenPay

payment platform, in the near future, we will offer a platform that connects online educators for example. In the coming time, Sendo will focus on investing in technology, as well as perfecting a comprehensive ecosystem to provide the best conditions for customers to use e-commerce. In particular, users' experience on mobile is a great concern of Sendo". Obviously, choosing and developing an effective and suitable business model is seen as an essential and crucial step for startups.

(Source: Sendo: A miracle of Vietnamese e-commerce platform, 2019)

Questions:

1. Discuss the importance of the business model to Sendo's early-stage success.

2. Dis choosing a different direction help Sendo rise strongly in the midst of the stiff competition of e-commerce in Vietnam?

4.1. Business models and their importance

The concept "business model" has been used in practice for several years, however companies create, define and innovate their models subconsciously from the start of business. Michael Lewis, the financial journalist, in his articles predicted that future companies will be based on business models connected only with the Internet. Teece (2010) considers that "business model still has no fixed theoretical foundation in economics". It is really difficult to identify those processes and components, which are necessary for business and would define a creation of value in a company comprehensively and fundamentally. Some authors just see a business model as the economic concept (Afual, 2003; Chesbrough, 2006; Mullins & Komisar, 2009; Baden-Fuller & Morgan, 2010). Nevertheless, Purely economic view of the business model does not represent a complex view on the company. The business model should (except of production revenues and costs) capture also the other side of the business and it is creating value. Therefore, according to Barringer and Ireland (2016), a company's business model refers to a plan or recipe for the company to create, distribute, and contribute value to its

owners/stakeholders. A company's business model also represents the core aspects of its business because it describes how the core aspects are relevant and mutually reinforcing. Take Sendo for example, the three key elements in Sendo's business model are the target market - rural people, the differentiation base - C2C, and the key assets - technology support from FPT and SBI. This case illustrates a very well-designed business model, at least because it involves the three elements in the Barringer/Ireland Business Model Template explained below.

4.2. General types of business models

There are two general types of business models: standard business models and disruptive business models.

4.2.1. Standard business models

Standard business models describe existing plans or ways that companies can use to determine how they will create, deliver, and capture value for their stakeholders. This type of model is commonly used by existing companies as well as those starting a business venture. Most standard business models, with the exception of the freemium model, have been around for a while. In fact, many of the business models used by online companies were originally developed by offline companies and simply switched to Internet-based applications. Amazon and eBay are typical examples of this type of model. Both these companies have a common thing in their business model which is they did not invent a new business model. They used the existing model. While Amazon transferred mail-order business model pioneered by Sears Roebuck and Company many years ago to operate online, eBay also moved the form of auction online. It is said that what Amazon.com and eBay have done, common in successful startups, is adopt a standard business model and build upon it in one or more meaningful ways to make a new way of creating value.

It takes for granted that there is no perfect business model because each standard model has inherent strengths and weaknesses. Besides, it is important to note that a company's business model needs to take it beyond its own boundaries. Meanwhile, many companies see other people's participation as an

integral part of their business models. One example is Apple, and specifically the Apple App Store. By the end of 2013, Apple App Store uploaded more than 1 million apps, created by more than 262,000 publishers. Every day, there were about 140 new apps added on the Apple App Store. Apparently, it is exactly a win-win situation for both Apple and developers. Developers have access to the platform to sell their apps, while Apple generates revenue. Thanks to the success of its app store, Apple launched iAd, a platform that allows app developers to sell ads on apps they offer through the Apple App Store. Therefore, Apple shares the revenue generated by the ads. Regardless of the business model a start-up is implementing, one thing new companies should be wary of is thinking that a particular business model is a "homerun" no matter the circumstances. While the peer-to-peer business model is hot right now, for business organizations like Airbnb and Uber, the use of a peer-to-peer business model is not enough to guarantee company success.

There are a lot of standard business models, which are shown in Table 4.1 below:

Table 4.1: Standard Business Models

Name	**Description**	**Examples of Entrepreneurial Firms (or Types of Firm) Utilizing This Model**
Advertising Business Model	Business model based on providing advertisers access to highly targeted customer niches.	Google. Facebook. YouTube
Auction Business Model	Currently synonymous with eBay, the auction business model has been around since 500 BC. The idea is to provide a platform for individuals and businesses to sell	eBay. uBid.com

Name	Description	Examples of Entrepreneurial Firms (or Types of Firm) Utilizing This Model
	items in an auction format.	
Bricks and Clicks Business Model	A business model by which a company integrates both offline (bricks) and online (dicks) presences.	Apple, Barnes & Noble. J. Crew
Franchise Business Model	A business model in which a firm that has a successful product or service (franchisor) licenses its trademark and method of doing business to other businesses (franchisees).	24 Hour Fitness. Panera Bread. School of Rock
Freemium Business Model	A business model in which a firm provides a basic version of its service for free, and makes money by selling a premium version of the service.	Dropbox. Evernote. Pandora
Low-Cost Business Model	A well-established business model that relies on driving down costs and making money by servicing a large number of customers.	Southwest Airlines, Warby Parker

Name	Description	Examples of Entrepreneurial Firms (or Types of Firm) Utilizing This Model
Manufacturer/Retailer Business Model	A business model in which a manufacturer both produces and sells (online, offline, or both) a product.	Apple, Fitbit. Tesla Motors
Peer-to-Peer Business Model	A model in which a business acts as a matchmaker between individuals with a service to offer and others who want the service.	Airbnb. Getaround. Task Rabbit
Razor and Blades Business Model	This model involves the sales of dependent goods for different prices-one good (a razor) is sold at a discount, with the dependent good (blades) sold at a considerably higher margin.	Game Consoles and Games. Mobile Phones and Air Time, Printers and Ink Cartridges
Subscription Business Model	A business model where the customer pays a monthly, quarterly, or yearly subscription fee to have access to a product or service.	Birchbox. Blue Apron. Netflix
Traditional Retailer Business Model	A business model calling for a firm to sell its products or services, made by others, directly to consumers at a markup from the original pnce. Can be sold online or offline.	Amazon. Whole Foods Markets. Zappos

(Source: Barringer and Ireland, 2016)

4.2.2. Disruptive business models

Different from Standard business models, Disruptive business models do not match the profile of a standard business model. This type of model is quite rate, however, disruptive business model are still impactful enough to disrupt or change the way business is conducted in an industry or an important niche within an industry.

Disruptive business models have two types, namely new market disruption and low-end market disruption. The first one - **A new market disruption** resolves a market that was not previously served. AdWords program of Google is a typically example of new market disruption. Before AdWords was established, online advertising was expensive for small businesses such as at least $10,000 for a minimal ad purchase paid for Yahoo. However, AdWords created a new market-disruptive business model, which provided a way for small businesses, in bulk, to advertise online. By allowing advertisers to buy keywords on the Google homepage, AdWords will trigger text-based ads next to the search results when the keyword is used. So if you type the words "Halloween clothes" into the Google search bar, you'll see ads paid for by companies selling Halloween clothes. Ads are normally paid on a pay-per-click basis. The cost of keywords depends on the popularity of the word.

The second one is known as a **low-end market disruption**, written by Harvard professor Clayton Christensen in his book The Innovator's Dilemma. Low-end disruption can occur when companies in an industry continue to enhance the quantity and quality of a product or service more than a significant portion of a customer's needs or wants. This "performance oversupply" creates a vacuum to deliver simple, often low-cost business models to exist. Examples here include Easyjet and Ryanair in Europe. These airlines created a no-frills, low-cost, point-to-point business model as an alternative to the more premium services offered by legacy carriers. By truly delivering what some would conclude as inferior service to its competitors, Easyjet and Ryanair could appeal to a large number of customers who wanted to pay a lower fare but still have a safe and comfortable ride. Low-end disruptive business models are also presented to provide a simpler, cheaper, or more convenient way to do a daily job. If a startup goes this route, the advantages must be attractive and the

company must be determined to let the disruption happen. When traditional rides cannot meet customers' needs, it needs to have a start-up to conduct something different to satisfy customer. A 2009 start-up Uber connecting people who need a ride with private car owners ready to offer the ride is a case applying disruptive business model to deal a daily taks (offers a cheaper and more convenient way to take a ride). Uber offers a compelling set of features - cars ordered by sending a text message or through an app, customers can track their pre-booked vehicle location, payouts are made through the app, there are no cash transactions between passengers and drivers, and Uber maintains strict quality standards for the vehicles and drivers participating in its service. Uber also attracts tech-savvy people who see a big advantage in using an app to book a ride instead of the often annoying taxi hailing process.

Table 4.2 below are actual disruptive business model used by different companies.

Table 4.2: Four Disruptive Business Models

Company	**Disruptive Business Model and Description**	**Standard Business Model That Was Disrupted**
Dell	Direct-to-consumer computer sales model, which allowed consumers to customize their computers Introduced the notion of buying a computer first over the phone and then via the Web. The customer would configure the computer and pay for it before the computer was assembled. Delivery via UPS or FedEx.	Computers that were assembled, shipped to a store, and then sat on shelves until someone bought them. No customization was possible because the computer was assembled before the customer bought it.

Company	Disruptive Business Model and Description	Standard Business Model That Was Disrupted
Google	AdWords (online advertising product) Introduced text advertising, which appears to the right or the top of organic search results, that when clicked takes the searcher to an advertiser's website or landing page. The text ads could be bought for as little at $1. Google's initial customers were small businesses who couldn't afford Yahoo's service.	Traditional banner advertising, provided by companies such as Yahoo. Some services required a minimum $10,000 ad buy for a company to advertise on the Internet.
Salesforce.com	SaaS (Software as a Service) provider of customer relationships management (CRM) software First company to offer CRM software as a SaaS product, making CRM affordable to small companies for the first time. By moving CRM to the cloud, it also enabled salespeople to access their CRM service anywhere they had an Internet connection.	Traditional installed CRM software, which required large licensing fees, provided by vendors such as Siebel Systems and PeopleSoft

Company	Disruptive Business Model and Description	Standard Business Model That Was Disrupted
Uber	Quickly connects riders with the owners of private cars who are willing to provide rides First company to provide riders with an app that connects them with the owners of private cars who are willing to provide rides. Advantages include: cleaner cars, avoiding the frustration of trying to hail a cab, direct billing via Uber so no money changes hands between the passenger and driver, and Uber knows the location of the nearest driver so pickup time is often reduced.	Local taxis and town-car services

(Source: Barringer and Ireland, 2016)

4.3. The Barringer/Ireland Business Model Template

To be successful, all companies need an effective and suitable business model. However, how to choose a suitable business model is always a "conundrum" for any entrepreneurs. It is noticed that many people also agree that a successful business model has a common set of attributes. These attributes are often presented in a visual framework or template so that individual parts can be easily seen and the reciprocal relationships between them.

According to Mullins and Komisar (2009) successful business model stands on five pillars, which predetermine the economic viability of the business including The revenue model, Gross margin model, Operating model, Working capital model and Investment model. This model gives just little

attention to the value, which is offered to the customer, and that is why this model is not useful for the complex analysis.

The concept of Afuah (2003) divides model into 4 components: industry factors, resources, positions and costs, hence the determinants of profitability (Figure 4.1), which influence all the activities in company. This model does not comprehensively define the company as a complex system. A business model should describe a system of creating revenue and value, their relationship with processes and provide a sufficient overview of the business model structure. Another weakness of this concept "is no connection of components into causal chain that would demonstrate the connectivity and bonds of elements. The concept does not allow the clear practical application to concrete numerical results (Stefan & Richard, 2014)". Model also includes component - industrial factors that does not belong to the business model. The external environment may well determine the characteristics of the business model, but is not part of it.

Watson (2005) shows and evaluates business model through six components: competitors, customers, economy, management, products and suppliers. He offers new and unusual insights into each component. This model has a complex character. Its uniqueness is that the model analyzes sector factors, such as competition, which belong to an environment of business model, but is not part of business model components.

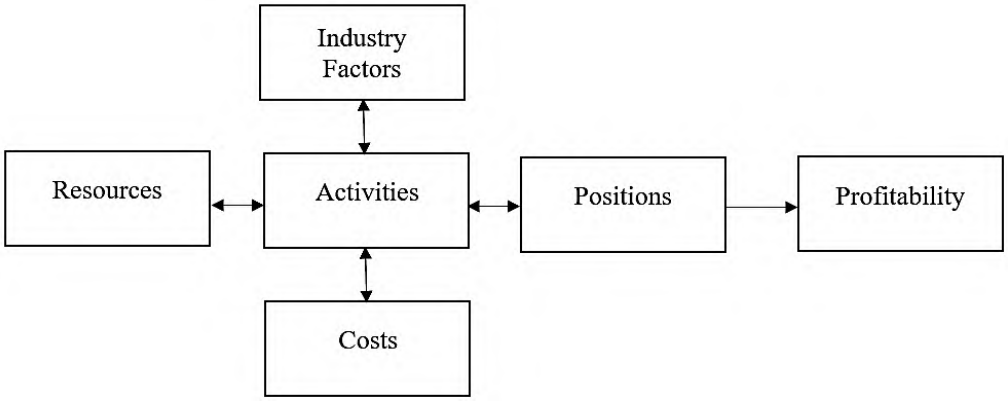

Figure 4.1: Components of business model by Afuah (2003)

(Souce: Afuah, 2003)

Another concept is made by authors Johnson et al (2008) who define business model as a set of four components, which are interconnected: value for a customer, profit formula, key resources and key activities. The concept comprehensively describes all the essential components of business.

Another widely used framework is the Business Model Canvas, designed by Alexander Osterwalder and Yves Pigneur. In their book, Business Model Generation, its authors described this framework as a business model consisting of nine elements corresponding to the nine pillars that make up a company's organization. Its main purpose is to assist the business in consolidating its business operations by illustrating the criteria of potential trade-offs.

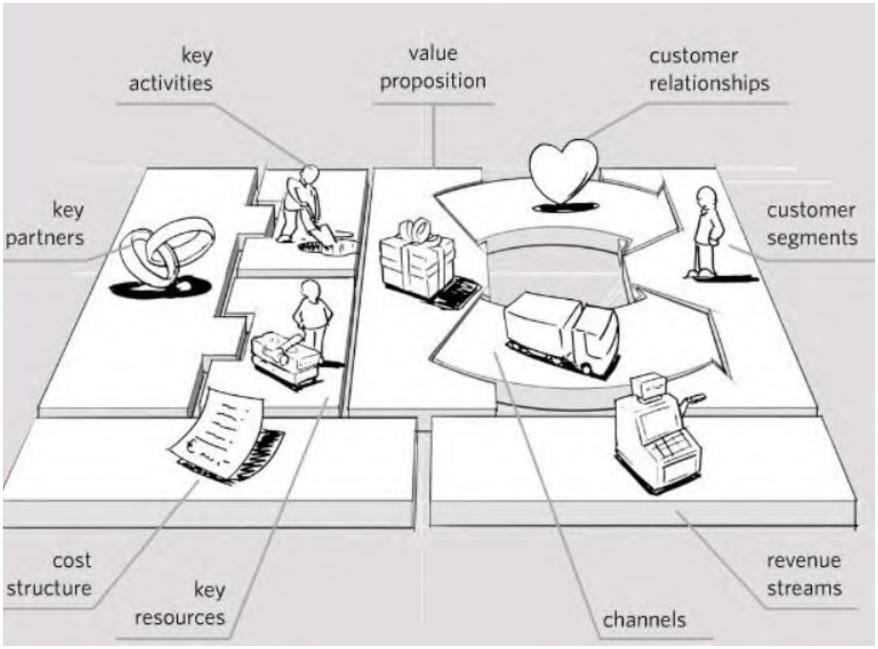

Figure 4.2. Business Model Canvas

(Source: Osterwalder and Pigneur, 2010)

However, the business model framework introduced in this chapter is the Barringer/Ireland Business Model Template. It is a bit more comprehensive than the Business Model Canvas. It includes 4 main categories and 12 individual sections. The 12 parts make up a company's business model. The entrepreneur or team of entrepreneurs have a mission which is to shape their

company's business model in a way that creates a viable and enjoyable business. Barringer/Ireland Business Model Template is also a tool that allows an entrepreneur to describe, project, modify and rotate a business model until all 12 parts are decided. The 12 sections are spread out, creating space for ideas to be captured, and discarded and recorded as ideas change and change.

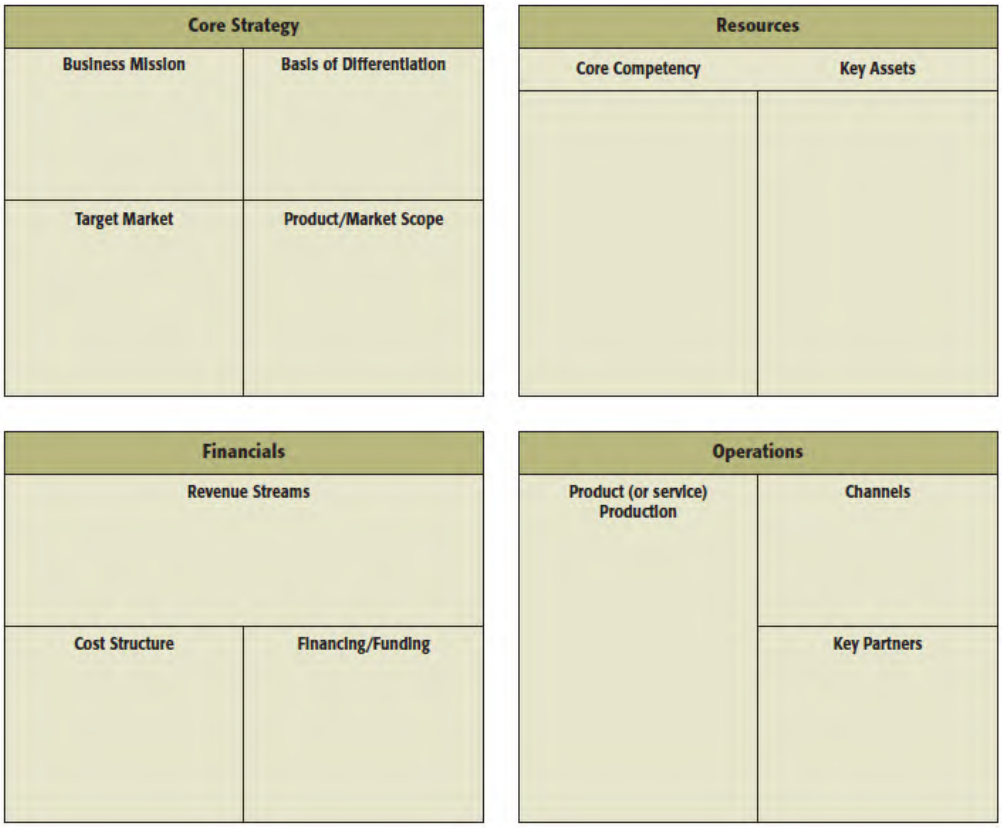

Figure 4.3: Barringer/Ireland Business Model Template

(Source: Barringer and Ireland, 2016)

4.3.1. Core strategy

The core strategy is the first component of the business model which explains how the company plans to compete with its competitors. In the core strategy, there are some significant elements comprising business mission, t basis of the differentiation, target market and product/market scope.

4.3.1.1. Business Mission

A business's mission or mission statement describes the reasons why the business exists and what its business model must achieve. If carefully written and used properly, a mission statement can clearly highlight your business's overall priorities and serve as the company's financial and ethical compass. A company's mission is to be the first box to be completed in the business model. A well-written mission statement is something a business can constantly refer back to when making important decisions in other elements of its business model. For example, Vingroup Corporation's mission is "To create a better life for people". Vingroup is a multidisciplinary corporation that aims to develop into a leading Technology-Industry-Services group in Vietnam. While Vingroup's mission statement is concise and accurate, it provides direction on how other elements in its business model should be shaped. The company will continuously innovate, create sustainable ecosystem of quality products and services, to improve the lives of the Vietnamese people, and elevate the position of Vietnamese brand globally. There are a few rules of thumb for writing mission statements. The mission statement of a business must:

- Identify "reason for existence"
- Describe what sets the company apart
- Be adventurous and challenging but attainable
- Use a tone that expresses the culture and values of the company
- Conveying passion and attachment in the mind of the reader
- Be honest and do not identify yourself as something the company "doesn't have"

4.3.1.2. Basis of differentiation

Apparently, a business must articulate what sets its product or service apart from its competitors. This is similar to what some authors call a firm’s value proposition. One company's basis of differentiation causes consumers to choose products from one company over the product of another. It is what solves a problem or fulfils a customer's need. The distinct sections should be limited to two to three points. Remember to guarantee that the values are easy

to see and understand. For example, LUSH is a makeup brand but unlike any other brands on the marketplace. This cosmetics maker has international reach with a local "warm and fuzzy" approach that is not afraid to push the boundaries. LUSH has two distinct differences: It is simple and genuine, with great contrast between visuals that is simple not seen elsewhere; it has the purity coming from a handmade item. For those reasons, LUSH has a massive brand loyal following.

Ensuring that your differences refer to benefits rather than characteristics is another important point to keep in mind when defining a company's basis of differentiation. Differences that focus on features, such as a product's technical advantages, are less appealing than points that focus on benefits, which is what a product can do. Take LUSH for instance, the benefits from the distinct points in its products are safety, reasonable price. The biggest success of LUSH is knowing that its core buyers value social and corporate responsibility over a luxurious and out-of-reach image.

4.3.1.3. Target market

It is extremely crucial to determine the target market the company will compete in. A target market is a location within a larger market segment that represents a narrower group of customers with similar interests. Most new ventures do not start out selling to large markets. Instead, most start by identifying an emerging or untapped niche in a larger market. The company's target market should be clearly shown on the business model. Sendo's target market is rural people. Starbucks' primary customers consists of men and women aged 25-40 who are hip, contemporary and willing to shell out a few extra dollars for a specialty drink (specialty coffee drinks account for 75% of Starbucks' sales). Hence, the target market a company chooses affects everything it does business, from the key assets it has to the financing or funding it needs to the partnerships the company formed.

4.3.1.4. Product/Market Scope

Product/market scope is the last element in the core strategy. A company's product/market scope expresses the products and markets it will

focus on. Most companies begin to narrow down and pursue the adjacent product and market opportunities as the company grows and becomes financially secure. This can be explained that new companies often do not have the resources to manufacture multiple products and pursue multiple markets simultaneously. One example is Dropbox, an online data storage company. When initially introducing its business idea, Dropbox had to encounter some problems including the vagueness of most people about the number of files they have or some other storage ways. At that time, the market it pursued was Silicon Valley tech savvy with a single product - an online data storage service. Since then, Dropbox's market has expanded to all users of computers and the Internet; The Company currently has more than 200 million customers. Moreover, Dropbox has set its own progress in 5-6 years as follows (Barringer and Ireland, 2016):

■ Launch-Single product/Silicon Valley tech-savvy users

■ 1-2 years into existence-Single product/Growing number of Silicon Valley tech-savvy users and people they told about the service

■ 3-4 years into existence-Single product/All computer and Internet users

■ 5 years into existence-Two products/All computer and Internet users

■ 6 years into existence-Three products/All computer and Internet users

Consequently, a company cannot set its initial product/market scope and forecast the product/market expansion in only 1-2 years. It should be at least 3-5 years like Dropbox above.

4.3.2. Resources

Resources are seen to be the second component of the business model. Resources are understood as assets that a firm owns and can exploit for economic purposes. A company must have enough resources to allow your business model to work. Resources in a business are often classified into two main categories: tangible and intangible resources. Tangible resources are the enterprise's assets that can be seen and quantified, including: cash, factories, equipment, human resources, offices… While intangible resources are intangible assets, including: knowledge and skills of individuals in the

business, relationship with partners such as retailers, other people's perceptions of the business's product and services. Resources are mentioned in the Barringer/Ireland Business Model Template consist of core competencies and key assets.

4.3.2.1. Core Competencies

A core competency is a specific factor or ability to support a company's business model and set it apart from its competitors. A core competencies is the combination of different resources that differentiate the business in the market. Core competencies meet three main criteria: (1) create added value for customers; (2) differentiate from rivals (not easy for rivals to imitate); and (3) scalable development (can exploit many products and markets). Therefore, the competency assessed as core competency must satisfy three criteria: (1) Valuable (Valuable resources will provide businesses with the flexibility they need to respond to environmental opportunities and to cope with operational environmental pressures. They also help organization increase the perceived value of their customers); (2) Race (Resources are scarce and not owned by other competitors); (3) Inimitable (A resource that is notoriously difficult to imitate is one that is not easily copied or duplicated by competitors). Viettel is a Vietnamese multinational telecommunications company. It is seen as one of the largest telecommunications service provider in Vietnam. Referring to Viettel's core competencies, it has special skills, products with a wide variety of charges to target all customers and cover most of the border areas, islands, remote areas which creates an advantage to compete. Viettel also focuses on after sales services and being the leader in promotional campaigns. Additionally, product development technology is another part in its core competencies.

4.3.2.2. Key Assets

Key assets are the assets that a company owns to enable its business model to operate. These assets describes the most important resources of the company for the business to survive. Key assets can be physical, financial, intellectual, or human. Physical assets include physical space, equipment, and

vehicles, distribution network. Intellectual property includes items such as patents, trademarks, copyrights and business methodologies. Financial assets may contains cash, stocks, bonds, mutual funds and bank deposits. Human assets include the founders of the company or its key staff and advisors. Each firm has different in key assets. For instance, Netflix, an American over-the-top content platform and production company, has key assets consisting of brand, app/website, content, algorithm and data, staff/actors/film makers and prizes. Meanwhile, for Zara, the Spanish apparel retailer specializing in fast fashion and products, its key assets comprise IT, patternmakers, distribution and marketing.

4.3.3. Financials

The third component of the Barringer/Ireland Business Model is financials. Finance is considered as a very important aspect of the business model because it will explain how the business makes money and gets profits. There are three principal factors of financials: revenue streams, cost structure and financing/funding.

4.3.3.1. Revenue Stream

Revenue stream is the method a firm uses to segment customers who buy its products/services. Revenue stream also represents the flow of business profits earned by its customer segments, hence it is the part that investors are most interested in. Some businesses have a single source of revenue, while others have some. The most common revenue streams are illustrated in Table 4.3 below.

Table 4.3: Most common revenue streams

Revenue Stream	Description
Advertising	Revenue generated from advertising a particular product or service in a newspaper, magazine, website, or in some other manner.
Commissions	Revenue generated by bringing two parties together to complete a sale. Etsy and eBay generate revenue in this manner. The money usually comes from taking a small percentage of the sale price.

Revenue Stream	Description
Download Fee	Revenue generated by allowing a user to download a digital product, such as a smartphone app, an e-book, or a software product.
Licensing	Revenue generated from charging for the use of a protected intellectual property, such as a software product.
Matchmaking	Revenue generated by matching someone who wants temporary access to an asset or competency with someone who owns an asset or has a competency and is willing to make it available. This is how peer-to-peer networks work. Examples include Airbnb, TaskRabbit, and Uber.
Product Sale	Selling a physical good-such as a product in a retail store or on a website.
Renting/Leasing	Revenue generated by renting or leasing an asset such as a rental car, a copy machine, or a piece of specialized machinery.
Service Sale	Selling a service-such as a meal in a restaurant or a car repair.
Subscription Service	Selling a subscription-such as Netflix for DVDs or streaming of content, or Birchbox for lifestyle samples.

(Source: Barringer and Ireland, 2016)

Generally speaking, revenue streams of retail businesses are more diverse, as compared to businesses that provide services such as restaurants, supermarkets.... For example, most restaurants have a single revenue stream. Some companies have more than one revenue stream as Netflix or Facebook. The primary sources of revenue for Netflix are DVD rental, subscription,

Netflix originals, movie and TV series while Facebook makes money from self-serve advertising, targeted advertisements, Facebook Messenger Ads, Video Ads, Facebook Mobile and Data generation. Furthermore, some other businesses are very creative in the way they make money. For instance, many online game providers offer the basic game for free and generates the majority of their revenue from a small number of users who buy premium products like special, time-saving shortcuts weapons and other features to enhance gameplay.

The number and nature of firm's revenue streams have a direct impact on other elements of its business model. All for-profit business needs at least one stream of revenue to fund their operations. Therefore, when filling out the Barringer / Ireland Business Model Form, you should clearly define your revenue streams.

4.3.3.2. Cost Structure

The cost structure of a business describes all the costs required to maintain and run a business model. To set up the basis of differentiation, developing core competencies, acquiring or developing key assets, forming partnerships…, any company must pay money or incur costs. However, In general, determining cost structure for a company has to depend on three factors: (1) which target of the business: cost saving or value oriented; (2) the nature of the business's costs and the main categories of expenses for the business.

Firstly, it is essential to determine the role of cost in a business because cost structure is subject to whether firms can be classified as cost-driven or value-driven. Cost-driven businesses focus on minimizing costs as much as possible like VietJet's low-cost airline ticket business while value-driven businesses concentrate on providing high-quality products/services like 4-5 star hotels (JW Marriot, InterContinental).

Secondly, it is important to recognize the nature of a business's costs. Costs can be classified into two categories fixed or variable. Fixed costs are expenses that do not change depending on volume of production or sales like rent, property taxes, insurance or interest payment. Variable costs are costs that

change according to the volume of production or sales such as labor, raw materials or administrative costs. Variable costs plus fixed costs equal to the total cost of production. While total variable costs change with increase in production or sales, total fixed costs do not change.

Thirdly, identifying the major cost of the business categories also affects a firm's cost structure, especially in the beginning when running the business. For example: Netflix's main costs are production-licensing and technology development while Facebook pay the majority of costs in platform, data maintenance-protection, content acquisition cost, research and development, customer service and marketing-advertising.

4.3.3.3. Financing/Funding

Finally, many business models are based on a certain amount of financing or funding to run the business. Obviously, most businesses incur costs before they generate revenue. Therefore, some entrepreneurs normally put their personal funds into their business at the beginning. However, when the business grows, their initial fund is not enough to meet the requirements of its operation. At that time, firms need to think to raise money from equity funding or debt financing which is discussed in chapter 9. In other cases, some businesses may be simple enough that it is funded from its own profits from the first day but it is quite rare. There is one thing to be noticed that at the business model stage projections, do not need to be completed to determine the exact money need. An approximation is sufficient.

4.3.4. Operations

Operations are integral and the final part in the Barringer/Ireland Business Model. Operations are seen as the heart of a firm because operations represent the day-to-day activities in the firm. The main elements of operations are: product (or services) production, channels and key partners.

4.3.4.1. Product/Service Production

This section emphasizes on the way that a company manufactures products and/or services. If a company sells physical products, the product can be produced in-house, by a contract manufacturer, or through an outsource

supplier. This decision will influence on a company's business model, particularly in developing its resources and raising capital. If the company chooses in-house production, it is necessary to develop core competencies in the production and procurement of key assets related to the manufacturing process, which require huge initial investment. On the contrary, if a company depends its production on the contract manufacturers or outsource providers, it need considering to find a suitable partners. For startups, it is not easy to convince any contract manufacturer or outsource provider to cooperate. In this case, although the company leave the name of partner blank, it should outline the production layout arrangement.

On the other hand, if a company provides a service instead of a physical product, then a brief description of how the service delivery will be produced. For example, BAEMIN is the leading food ordering application in Korea. When coming to Vietnam, BAEMIN's mission is to "Help people eat well anytime, anywhere", its business model reports briefly how it work "Customers can do on the application with just few simple steps - choose food, choose the nearest store and order, and then enjoy food, which will be delivered quickly for an extremely reasonable price".

4.3.4.2. Channels

The company's channels describe distribution channels used to engage customer segments, thereby giving customers the target value that they want. In other words, it exactly show how a company delivers its products or services for its customers. There are many different channels including direct distribution channels (direct sales team, direct selling points, online stores…) and indirect distribution channels (sales agents, partners' stores…) or combination of both. For example, Zara uses direct channels by selling its products out of 2000 stores in 77 countries and via the company's main website Zara.com. In general, small enterprises sell direct products/services to their customers. However, when those enterprises develop and expand their businesses, they have to establish indirect channels. Besides, many firms choose both direct and indirect channel for distributing their products/services at the beginning of running the business. Vietjet Air's distribution channels

includes box office systems at airports in Hanoi, Da Nang, Ho Chi Minh, Nha Trang and Vietjet Air's agents and online ticket booking. In some cases, some firms employ a sale force that call potential customers to try to close sales, particularly in selling new products/services.

A company's channel selection influences other aspects of its business model. For startups, the first step is establishing a distribution channel is to determine which channels are their customers. The point of contact with customers can be limited or varied depending on the company's strategy. Hence, entrepreneurs need applying some methods to assess the strengths of different distribution channels. Finally, businesses can identify and build new customers' channels.

4.3.4.3. Key Partners

In order for the business model to work effectively and minimize risks, businesses should build partnerships with high quality suppliers and others. Key partners are the final element in a company's business model. In particular, startups often do not have sufficient resources (or funding) to perform all the necessary tasks to make their business models work, thus they do rely on partners to perform key roles.

The first partnership that many businesses cooperate is with suppliers. A supplier (or vendor) is a company providing parts of service to another company. Almost all companies have suppliers who play an important role in their operating their business models. Shopee is a Singaporean multinational technology company which focuses mainly on e-commerce. When coming to Vietnam, Shopee started as a C2C (Customer to Customer) model, which build a huge network of buyers and sellers without any inventory concerns. Thereafter, driven by the dizzying wave of users, Shopee is even easier to start working with its B2C (Business to Customer) model, bringing industry-leading suppliers to its platform to compete directly with Lazada. It can be seen that suppliers are very crucial in Shopee's business model.

Together with suppliers, companies cooperate with other companies for their implementation of business models. The most common types of relationships comprising strategic alliances and joint ventures, shown in Table 4.4. One typical example is strategic partnership between GM and VinFast

sealed in 2018. Through the GM Alliance, VinFast became Chevrolet's exclusive distributor, combining VinGroup's unique retail position on the market and GM's existing dealer network. VinFast also acquired GM's Hanoi Factory. The global production of a brand new small car, licensed from GM and sold under the VinFast brand, launched in 2019. GM became the preferred automotive technology provider for VinFast, opening the door for product sharing and future technology transfer.

When completing the Barringer/Ireland Business Model, you should identify your primary supplier partnership and other partners. Typically, a startup begins with a fairly small number of partnerships, developing over time.

Table 4.4: The most common types of Business Partnership

Partnership Form	Description
Joint venture	An entity created by two or more firms pooling a portion of their resources to create a separate, jointly-owned organization
Network	A hub-and-wheel configuration with a local firm at the hub organizing the interdependencies of a complex array of firms
Consortia	A group of organizations with similar needs that band together to create a new entity to address those needs
Strategic alliance	An arrangement between two or more firms that establishes an exchange relationship but has no joint ownership involved
Trade associations	Organizations (typically nonprofit) that are formed by firms in the same industry to collect and disseminate trade information, offer legal and technical advice, furnish industry-related training, and provide a platform for collective lobbying

(Source: Barringer and Harrison, 2000)

Review Questions

4.1. What is the definition of a business model?

4.2. How many types of business models? Compare these types.

4.3. Discuss whether Netflix case is a standard business model or a disruptive business mode.

4.4. What are four major categories in the Barringer/Ireland Business Template?

4.5. What are components in Core Strategy/Resources/Financials and Operations?

4.6. Take an example and analyze its business model following the Barringer/Ireland Business Templae.

CHAPTER 5:
INDUSTRY ANALYSIS AND NEW VENTURES

Abstract: This chapter introduces different concepts and frameworks for industry and competitor analysis. These can be used at different levels of detail. The industry overview sets the scene for the readers of the business plan. The first section of the chapter discusses industry analysis, which is business research that focuses on the potential of an industry. An industry is defined as a group of companies producing a similar product or service, such as clothes, cosmetics or musical instruments. Once it is determined that a new venture is feasible in regard to the industry and the target market in which it intends to compete, a more in-depth analysis is needed to learn about a variety aspects of the chosen industry. You will learn how to evaluate the level and nature of competitive behaviours by applying Michael Porter's Five Forces Model.

The chapter's second section is concerned with a competitor analysis which is an analytical assessment of the behaviours of the firm's competitors. Once it is determined that a firm will enter an industry and chooses a market in which to operate, it must gain an understanding of its competitive environment. This analytical evaluation will lead to answers regarding the firm's business model and function.

Learning Objectives

By the end of this chapter, students will be able to:

1. Explain the purpose of an industry analysis
2. Identify and discuss the five competitive forces that determine industry profitability
3. Compare different stages of industry development
4. Explain the purpose of a competitor analysis and a competitive analysis grid
5. Describe different types of competitive analyses

Case study: A brief structural analysis of the games console industry

Video games achieved almost 50 percent growth (2007 estimated) between 2002 and 2007, making it the high achiever among all leisure sectors (Mintel, 2008).

Competitive rivalry

During the 1990s the market was dominated by three manufacturers: Sony, Nintendo and Sega. By 2002 Table 2 shows there were still three key players in the market. Sony was still the leader in the three major markets, Europe, Japan and America, the so-called triad. Nintendo occupied second place, with Microsoft in third. Sega lost its position.

By 2008, Sony had lost the first-mover advantages that it established with its PS2. Capacity to innovate remains a clear key skill in this market. Even Sony's strong brand name has not enabled it to remain as market leader, apart from in Japan. Although Sony will come back strongly, Nintendo has always been a strong player in the console industry. It has benefited from the big sales of its Wii console which is innovative and designed to attract new game players into the market. The Xbox 360 has been able to gain ground on the PS3 partly because of the technical problems that delayed the launch of the PS3 and perhaps the fact it was a cheaper, yet comparable package.

Power of suppliers

In the games console market suppliers have little power. They are hardware and software providers who, to a certain degree, rely heavily on the console manufacturers.

Power of buyers

The final consumer also has little power, although prices of the main consoles have come down since launch. Manufacturers can still 'call the shots' when dealing with a distributor.

Threat of substitutes

PC games used to be a strong substitute but sales have fallen year on year; consoles are primarily designed for game play and are the kit choice for most game players. However, social games such as Farmville, Mafia Wars and Pet Society on Facebook, Bebo, MySpace and on iPhone provide a viable

alternative to consoles. They are free, widely available and easy to play. Evidence suggests that gamers are leaving traditional consoles. This has spurred revenue growth at Facebook which is now the world's largest games portal. The ten most popular games on Facebook draw over 100 million users a month. Indeed Xbox and Nintendo have already spotted this development and are already moving in. It has been estimated that the social games market could triple to $2 billion by 2012. It is also possible that the demand for consoles could slow down as players move on to other activities, choosing to spend their money completely outside the market.

Threat of entry

The number and impact of potential entrants are not totally clear, but as games consoles are likely to evolve into devices that include gaming, home entertainment and PC capabilities, the dominant players in each of these industries may want to move into the market. Microsoft's success in this respect may point a way forward

Questions:

1. Use Porter's five forces model, as we have here, to analyse the competitive environment of an industry of your choice.

2. What other key concepts raised in the chapter could also be useful in this analysis?

Source: Brooks, Weatherston and Wilkinson (2004)

5.1. Introduction

Industry and competitive analysis plays an important role in any strategy development of organizations. It consists of a very practical set of methods to quickly obtain a good understanding of an industry, be it food, beverage, entertainment or pharmaceuticals industry. Industry and competitive analysis aims to analyse factors that impact the performance of the industry, and as well the performance of companies within the industry. As the world has been revolutionalised with tremendous innovations, many industries are in the process of transforming from analogue to digital business model. Digitalization

is creating drastic changes to companies' offerings and operations. Therefore, there is a need for advanced set of analytical tools to understand industries and adapt to such changes.

5.2. Stages of industry development

The first step in an industry assessment is determining the basic nature of the industry in which the entrepreneur's business will need to compete. Industries evolve over time, both structurally and in terms of overall size. The industry life cycle is measured in total industry sales and the growth in total industry sales. The industry structure and competitive forces that shape the environment in which businesses operate change throughout the life cycle. The five most prevalent industry types are emerging industries, fragmented industries, mature industries, declining industries, and global industries. There are unique opportunities associated with each type of industry.

Table 5.1. Stages of industry development

Industry Type	Industry Characteristics	Opportunities	Examples of Entrepreneurial Firms Exploiting These Opportunities
Emerging industries	Recent changes in demand or technology, new industry standard operating procedures have yet to be developed	First-mover advantage	Brain Sentry's device to help detect sports-related concussions Windspire in small-scale wind-generated power Buzzy's procedure that helps relieve the pain and anxiety associated with getting a shot
Fragmented industries	Large number of firms of approximately equal size	Consolidation	Chipotle Mexican Grill in fast-casual restaurants 1-800-GOT-JUNK? in junk removal Modcloth in women's clothing

Industry Type	Industry Characteristics	Opportunities	Examples of Entrepreneurial Firms Exploiting These Opportunities
Mature industries	Slow increases in demand, numerous repeat customers, and limited product innovation	Process and after-sale service innovation	Justin's in peanut butter Pure Fix Cycles in bicycles Flings Bins in trash bags
Declining industries	Consistent reduction in industry demand	Leaders, niche, harvest, and divest	Nucor in steel JetBlue in airlines Cirque du Soleil in circuses
Global industries	Significant international sales	Multinational and global	PharmaJet in needleless injection systems d.light in solar-powered lanterns

(Source: Barringer and Ireland, 2016)

5.2.1. Emerging Industries

Emerging markets are generally seen as offering new companies with the best opportunities. An emerging industry is a group of companies in a line of business formed around a new product or idea that is in the early stages of development. An emerging industry typically consists of just a few companies and is often centered around new technology. Emerging industries frequently come into existence when one technology begins to eclipse and replace an older technology. If an entrepreneur has goods or services whose customer need has not been unrecognized or unmet, fewer existing rivals will face them. The new enterprise gains what is called the "first mover advantage" in an optimal situation and is accepted by the consumer niche as the business ideally suited to fulfill these new needs. Examples include robotics, virtual reality, 5G networks, blockchain technology, artificial intelligence, and self-driving cars. Also, emerging industries in the past are considered well-established industries

today. In the 1990s, the internet was a new technology that became increasingly popular, creating the dotcom bubble.

5.2.2. Fragmented Industries

A fragmented industry is characterized by a large number of firms of approximately equal size. In this sense, the number of competitors increases rapidly as other firms enter the growing industry. The primary opportunity for new companies in fragmented industries is to consolidate the industry and establish industry leadership as a result of doing so. The most common measure to do this is through merge and acquisition, which is an often observed path for growth for businesses such as auto repair shops and beauty salons. It is challenging for them to yield additional income in a single location, expanding into new geographic locations is a better choice to make firms profitable. However, during this stage the power of buyers is still very low because demand exceeds supply while industry growth is associated with high profitability. Firms may be needing capital for running and standing a high risk as they jockey for position and market share.

5.2.3. Mature Industries

A mature industry is an industry that has passed both the emerging and fragmentation phases of industry growth. Companies from such industries are not expected to grow at the same pace that may have characterized the earlier phases of development. This may be due to the industry already approaching the point of market saturation in terms of reaching available customers. Over time, failures and consolidations will distill the business to the strongest as the industry continues to grow. This is the period where the surviving companies are considered to be mature. Eventually, growth will slow as new or innovative products or services replace this industry offering and begin a new industry lifecycle.

For example, the film photography was a mature and stable industry given there were few true alternatives to the medium until digital photography reached a stage of development that could consistently reproduce, at a comparable cost, the clarity of film photos. While there are nuanced reasons why film photography remains popular with some niche users, the consumer market largely shifted to using digital.

5.2.4. Declining Industries

A declining industry is an industry where growth is either negative or is not growing at the broader rate of economic growth. This is the scenario when the industry fail to keep pace with the rest of the country's economic growth, or when its rate of growth declines across studying periods. This can be ascribed to a multiple of reasons: consumer demand may be steadily evaporating, the depletion of a natural resource may be occurring or there may be the emergent substitutes because of technological innovation. For example, the railroad industry has experienced decreased demand-largely due to newer and faster means of transporting goods (primarily air transport and trucking)-and has failed to remain competitive in pricing, at least in relation to the benefits of faster and more efficient transport provided by airlines and trucking services.

5.2.5. Global Industries

Global industries refers to industries that effectively operate in all, or most, of the markets across the world. In other words, they are market niches that have common characteristics in multiple nations. These industries offer roughly equivalent products or services to customers in every market, and the competitive position of companies in such industries depends on performance across all markets. As a rule, they operate an information technology and communication infrastructure that spans the globe. The products or services the industry provides require little or no modification to serve customers in all markets. For example, razors serve a universal need and require no modification to sell in almost any market. The industry secures advantageous economies of scale by serving a global market. In most cases, some modifications of the firm’s products or services need to be made to tailor these to the unique requirements of each potential market. At the opposite end of the spectrum is a truly global strategy that sacrifices responsiveness to local requirements in favor of efficiency and does not make too many modifications of the firm’s products or services. Serving global industries can become potentially complicated, whatever strategy a company follows. The entrepreneur must factor in issues such as government laws and regulations,

cultural differences, and economic factors, for example, the customers' ability to pay and the company's ability to force payment in a foreign country.

5.3. Industry analysis

Industry analysis is a critical part of understanding a company's market position. It should tell you whether a company is faring better or worse than companies that offer similar products and services. Industry analysis is the analysis of a specific branch of manufacturing, service, or trade. Understanding the industry in which a company operates provides an essential framework for the analysis of the individual company-that is, company analysis. At its core, industry analysis is designed to help you figure out how a company operates within an industry. An industry analysis consists of three major elements: the underlying forces at work in the industry; the overall attractiveness of the industry; and the critical factors that determine a company's success within the industry.

One way in which to compare a particular business with the average of all participants in the industry is through the use of ratio analysis and comparisons. Ratios are calculated by dividing one measurable business factor by another, total sales divided by number of employees, for example. By comparing a particular ratio for one company with that of the industry as a whole, a business owner can learn much about where her business stands in comparison with the industry average. For example, a small nursing home business can compare its "payroll per employee" ratio with the average for all residential care operators in the U.S. in order to determine if it is within a competitive range. If her business's "payroll per employee" figure is higher than the industry average, she may wish to investigate further. Checking the "employees per establishment" ratio would be a logical place to look next. If this ratio is lower than the industry average it may justifying the higher per-employee payroll figure. This sort of comparative analysis is one important way in which to assess how one's business compares with all others involved in the same line of work.

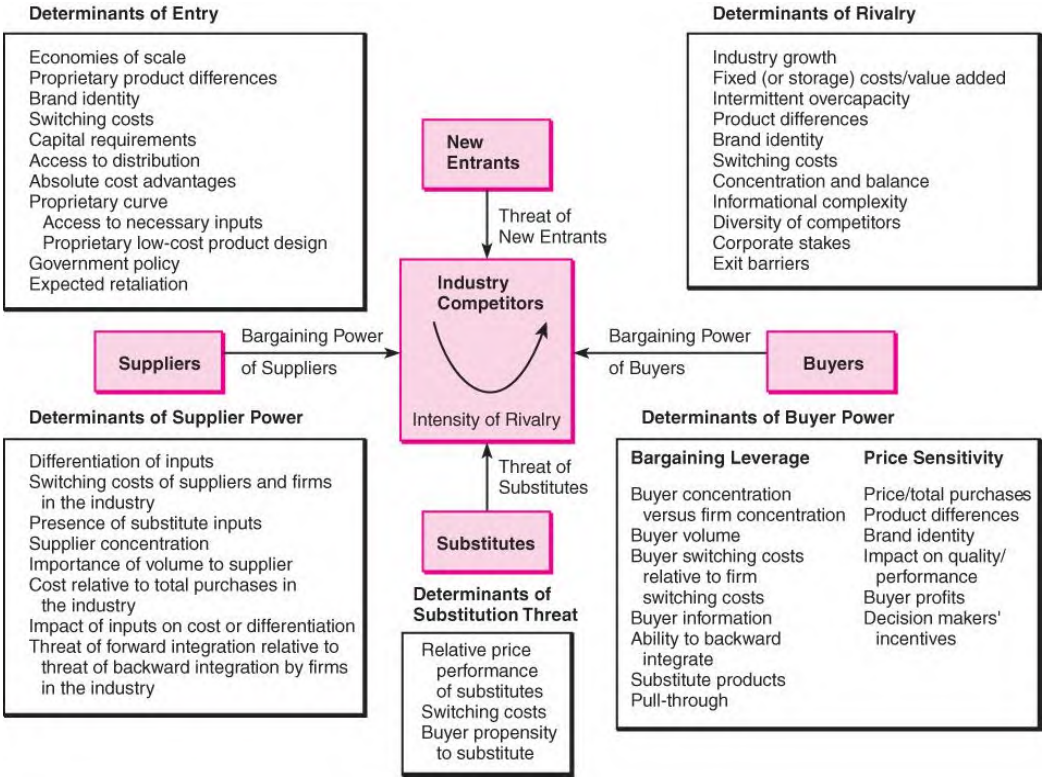

Figure 5.1: Porter's Five Forces Model

(Source :Porter, 1980)

Another premier model for analyzing the structure of industries was developed by Michael E. Porter in his classic 1980 book Competitive Strategy: Techniques for Analyzing Industries and Competitors. Porter's model shows that rivalry among firms in industry depends upon five forces: 1) the potential for new competitors to enter the market; 2) the bargaining power of buyers; 3) the bargaining power of suppliers; 4) the availability of substitute goods; and 5) the competitors and nature of competition.

Michael Porter of Harvard University developed the ***five forces model of competition***. This model is a powerful tool for assessing the anticipated level of competition that will exist in an industry. Porter stated. "The goal of competitive strategy for a business unit in an industry is to find a position in the industry where the company can best defend itself against these

competitive forces or can influence them in its favor." Understanding the underlying forces determining the structure of the industry can highlight the strengths and weaknesses of a small business, show where strategic changes can make the greatest difference, and illuminate areas where industry trends may turn into opportunities or threats. Each element of the model provides the entrepreneur with a series of potential strategic challenges, which have the power to shape the intensity of the rivalry that exists in the industry.

This analysis is far from theoretical. As an entrepreneur, you can evaluate any industry that you are considering entering to determine objectively the nature of the competitive forces you are likely to encounter. The conclusions you are able to reach based on your assessment will serve to assist you in determining the potential of strategic success and strategies for attaining it. Porter's five forces model is a highly valued analytical tool for the assessment of new venture success.

5.3.1. Threat of Substitutes

Threat of substitutes occurs when companies within one industry are forced to compete with industries producing substitute products or services forces, reflecting the intensity of competition in the industry. Competition is enhanced when the industry players feel pressure from a potential competitor who is capable of offering products or services comparable to their own. The closer these substitutes are in price and quality to those of the entrepreneur wanting to enter the industry, the greater the competitive pressure. Accordingly, A substitute product is a product from another industry that offers similar benefits to the consumer as the product produced by the firms within the industry.

If there are a number of substitutes for a product or service on the market, buyers have more options to seek out similar products or services. It is important for clients to ensure their product or service maintains demand among customers. That way, even if a substitute appears at some point, customers will trust the quality of their product or service regardless. For example, Microsoft Excel can be viewed as a substitute for project management software or different calendar apps. When a substitution for a

company's product or service that is currently on the market appears, it can be potentially damaging. If the product or service substitution includes many similar features at a much lower price, buyers may be tempted to use an alternative. This is why it's so important to understand your buyers on a deeper level.

Competitive pressure is one of the factors determining the profitability of an industry. The threat of substitution in an industry affects the competitive environment for the firms in that industry and influences those firms' ability to achieve profitability. The availability of a substitution threat effects the profitability of an industry because consumers can choose to purchase the substitute instead of the industry's product. The availability of close substitute products can make an industry more competitive and decrease profit potential for the firms in the industry. On the other hand, the lack of close substitute products makes an industry less competitive and increases profit potential for the firms in the industry. A threat of substitutes example is the beverage industry due to a market with many competitors. Thus, entrepreneurs must evaluate the operational components of their business models and the dynamics of the industries in which they are considering competing to determine if proposed ventures have the potential to meet their profitability expectation.

5.3.2. Threat of New Entrants

New entrants to an industry add capacity, and if the capacity added is greater than growth in demand, this will reduce profitability. Threat of new entrants refers to the threat new competitors pose to existing competitors in an industry. Therefore, a profitable industry will attract more competitors looking to achieve profits. If it is easy for these new entrants to enter the market - if entry barriers are low - then this poses a threat to the firms already competing in that market. More competition - or increased production capacity without concurrent increase in consumer demand - means less profit to go around. To be more specific, a high threat of entry means new competitors are likely to be attracted to the profits of the industry and can enter the industry with ease. New competitors entering the marketplace can either threaten or decrease the market share and profitability of existing competitors and may result in changes to existing product quality or price levels. An example of the threat of new

entrants porter devised exists in the graphic design industry: there are very low barriers to entry. A high threat of new entrance can both make an industry more competitive and decrease profit potential for existing competitors. On the other hand, a low threat of entry makes an industry less competitive and increases profit potential for the existing firms. New entrants are deterred by barriers to entry.

Factors involved as barriers to entry may be either innocent (for example, the dominating company's absolute cost advantage) or deliberate (for example, high spending on advertising by incumbents makes it very expensive for new firms to enter the market). The threat of new entrants is low in cases where:

- *Profitability requires economies of scale*
- *Products are differentiated*
- *Brand names are well-known*
- *Initial capital investment is high*
- *Consumer switching costs are high*
- *Accessing distribution channels is difficult*
- *Location is an issue*
- *Proprietary technology is an issue*
- *Proprietary materials is an issue*
- *Government policy is an issue*

New entrants may seek not to replicate the value chain of existing firms but to focus on certain activities where barriers to entry are lower. For example, a firm may enter the market for a product but subcontract the manufacturing to a low-cost producer and concentrate on r&d, sales and marketing, and distribution. A business that has achieved economies of scale in one industry may be able to apply these economies in another industry. An example would be an electricity retail distributor which starts to retail gas and telephone services, thus leveraging existing meter-reading staff and billing systems.

The objective of competitive strategy should be to deter new entrants if this is possible. Where scale economies matter, pricing is an important weapon. However, when pricing becomes predatory, regulators often step in to protect

new entrants. In general, governments seek to foster competition and step in where structural factors prevent competition from emerging. An example is the ice cream industry in the UK, where certain manufacturers supplied freezers to retailers and prevented their use for other brands. Government intervention removed this barrier to entry. Incumbents must judge carefully how to use structural factors as a barrier to entry; used without political awareness, strategies that seek to prevent new entrants may backfire.

5.3.3. Rivalry among Existing Firms

The intensity of rivalry among competitors in an industry refers to the extent to which firms within an industry put pressure on one another and limit each other's profit potential. Industry rivalry usually takes the form of jockeying for position using various tactics (for example, price competition, advertising battles, product introductions). This rivalry tends to increase in intensity when companies either feel competitive pressure or see an opportunity to improve their position.

In most industries, one company's competitive moves will have a noticeable impact on the competition, who will then retaliate to counter those efforts. Companies are mutually dependent, so the pattern of action and reaction may harm all companies and the industry. If rivalry is fierce, then competitors are trying to steal profit and market share from one another. As a result, this reduces profit potential for all firms within the industry. According to Porter's 5 forces framework, the intensity of rivalry among firms is one of the main forces that shape the competitive structure of an industry.

The intensity of rivalry or competition among firms competing in the same industry depends on a number of factors:

Numerous or equally balanced competitors: When there are many competitors, some companies believe that they can make competitive moves without being noticed. When companies are relatively balanced in strength, they are more likely to engage in competitive battles and attack and retaliate as they strive for market leadership.

Slow industry growth: In a slow growth market, companies can only grow by capturing market share from each other, which leads to increased

competition; in other words, competition will intensify until some competitors exit or consolidation takes place.

High fixed or storage costs: High fixed costs create pressure for all companies to fill capacity, thus leading to price cutting when there is excess capacity. High storage costs push companies to decrease prices to ensure sales.

Lack of differentiation or switching costs: When products are perceived as commodities, choice is often determined by price and service, which then leads to increased competition in price and service. In the case of commodity markets - those with undifferentiated products such as grain or computer ram - competition focuses on price, which is particularly damaging to all manufacturers. Where there is scope for differentiation, price competition will be lower. In markets where products or services are perishable, competition becomes more intense when sales have to be made. An example is last-minute summer holiday bookings.

Capacity increased in large increments: When economies of scale require large increases in capacity, it causes disruptions in the industry supply/demand balance, which then leads to periods of overcapacity and price cutting.

Diverse competitors: Companies with diverse strategies, origins, personalities and relationships to parent companies (especially foreign competitors) also have different competitive goals and strategies than "typical" companies within the industry. Their diverse approaches to the market and unique competitive strategies can upset the status quo of doing business.

High strategic stakes: Companies with high stakes in achieving success may sacrifice profitability for expansion. Also, companies with high market share may feel threatened by competitors seeking to reduce their market share.

High exit barriers: Economic, strategic and emotional factors can prevent companies from leaving the industry, even when they are earning low or negative returns on investments. Major sources of exit barriers include: specialized assets, fixed costs of exit, strategic interrelationships, *e*motional barriers, *g*overnment and social restrictions.

5.3.4. Bargaining Power of Suppliers

Bargaining power of suppliers refers to the pressure suppliers can exert on businesses by raising prices, lowering quality, or reducing availability of their products. When analyzing supplier power, industry analysis should be conducted from the perspective of the industry firms or the buyers. Strong suppliers can pressure buyers by raising prices, lowering product quality, and reducing product availability. All of these things represent costs to the buyer. Furthermore, a strong supplier can make an industry more competitive and decrease profit potential for the buyer. On the other hand, a weak supplier, one who is at the mercy of the buyer in terms of quality and price, makes an industry less competitive and increases profit potential for the buyer.

The supplier power Porter has studied includes several determining factors. If suppliers are concentrated compared to buyers - there are few suppliers and many buyers - supplier bargaining power is high. Conversely, if buyer switching costs - the cost of switching from one supplier's product to another supplier's product - are high, the bargaining power of suppliers is high. If suppliers can easily forward integrate or begin to produce the buyer's product themselves, then supplier power is high. Supplier power is high if the buyer is not price sensitive and uneducated regarding the product. If the supplier's product is highly differentiated, then supplier bargaining power is high. The bargaining power of suppliers is high if the buyer does not represent a large portion of the supplier's sales. If substitute products are unavailable in the marketplace, then supplier power is high.

Therefore, the following conditions indicate that a supplier group is powerful:

- *It is dominated by a small number of companies and is more concentrated than the industry to which it sells*
- *It is not required to contend with substitute products for sale in the industry*
- *The industry is not one of the supplier's important customers*
- *Its products are an important part of the buyer's business*
- *Its products are differentiated or there are built-up switching costs*
- *It poses a definite threat of forward integration*

5.3.5. Bargaining Power of Buyers

buyer bargaining power refers to the pressure consumers can exert on businesses to get them to provide higher quality products, better customer service, and lower prices. Buyers possess the power to negotiate lower prices when a new business venture needs their orders to survive. When analyzing the bargaining power of buyers, conduct the industry analysis from the perspective of the seller. Typically, buyers who make larger than normal purchases have the capability to exercise strength in negotiating lower prices in the form of volume dis- counts. Strong buyers can also pressure sellers to lower prices, improve product quality, and offer more and better services. All of these things represent costs to the seller. A strong buyer can make an industry more competitive and decrease profit potential for the seller. On the other hand, a weak buyer, one who is at the mercy of the seller in terms of quality and price, makes an industry less competitive and increases profit potential for the seller.

The bargaining power of larger buyers normally exists due to the economic reality that it is less expensive to sell in high volume. New ventures will always be at a disadvantage until they are on a more equal footing with the buyers. The new venture will have a negotiating advantage when their products or services are uniquely superior to those of competitors. A new venture can gain additional economic power when products possess intellectual property protection, such as patents, copyrights, and trademarks.

Several factors determine Porter's Five Forces buyer bargaining power. If buyers are more concentrated than sellers - if there are few buyers and many sellers - then buyer power is high. Whereas, if switching costs - the cost of switching from one seller's product to another seller's product - are low, the bargain power of buyers is high. If buyers can easily backward integrate - or begin to produce the seller's product themselves - the bargain power of customers is high. If the consumer is price sensitive and well-educated about the product, then buyer power is high. Then if the customer purchases large volumes of standardized products from the seller, buyer bargaining power is high. If substitute products are available on the market, buyer power is high.

To summarize, Buyer Power is High/Strong if:

- *Buyers are more concentrated than sellers*
- *Buyer switching costs are low*
- *Threat of backward integration is high*
- *Buyer is price sensitive*
- *Buyer is well-educated regarding the product*
- *Undifferentiated product*
- *Buyer purchases product in high volume*
- *Substitutes are available*
- *Buyer purchases comprise large portion of seller sales*

5.4. Competitor Analysis

After a firm has gained an understanding of the industry and the target market in which it plans to compete, the next step is to conduct a competitor analysis. A competitor analysis is a detailed analysis of a firm's competition. It helps a firm understand the positions of its major competitors and the opportunities that are available to obtain a competitive advantage in one or more areas. For example, take a company such as Vingroup. Primarily, the company deals with real estate. But Vingroup is not only in the real estate business; in fact, the company is also working other disciplines such as retail or services ranging from healthcare to hospitality. Therefore, it has a broader set of competitors and opportunities to consider. In addition, some firms sell products or services that straddle more than one industry. For example, a company that makes computer software for dentists' offices operates in both the computer software industry and the health care industry. Again, this type of company has more potential competitors but also more opportunities to consider.

In this part we will firstly discuss how a firm identifies its major competitors. We will then look at the process of completing a competitive analysis grid, which is a tool for organizing the information a firm collects about its primary competitors.

The different types of competitors a business will face are shown in Figure 5.2. The challenges associated with each of these groups of competitors are described here:

■ **Direct competitors:** These are companies offering the same service or products as you in the same geographical area - targeting the same audience and serving the same needs. These competitors are the most important because they are going after the same customers as the new firm. A new firm faces winning over the loyal followers of its major competitors, which is difficult to do, even when the new firm has a better product.

■ **Indirect competitors:** These are companies who offer the same, or similar, services and products to you in the same area, but who are serving a different need or purpose or targeting a different audience. These firms' products are also important in that they target the same basic need that is being met by the new firm's product.

Direct Competitors
Businesses offering identical or similar products
Indirect Competitors
Businesses offering close substitute products
Future Competitors
Businesses that are not yet direct or indirect competitors but could be at any time

Figure 5.2: Types of competitors new venture face

(Source: Barringer and Ireland, 2016)

■ **Future competitors:** These are companies that are not yet direct or indirect competitors but could move into one of these roles at any time. This might be the larger national company that hasn't entered your local market yet. Firms are always concerned about strong competitors moving into their markets. To illustrate, For Purma Top Gifts, a future competitor is an existing brick-and-mortar gift shop in Purma that decides to start selling products online. One obvious source of future competition is an indirect competitor. As soon as an indirect competitor sees you having success in their area with a different product, they may try to duplicate your offerings and so they become a direct, perhaps formidable, competitor.

Identifying all existing and potential sources of competition is an impossible task, indirect and future competitors can number in the tens, hundreds, or even thousands. Instead, you will have to draw the line somewhere when it comes to identifying major competitors - the ones that are going to have a real impact on the business over time. While the nature of competition in the industry will determine the number of major competitors that need to be considered in the competitor analysis, it is recommended that identifying its top 5 to 10 direct competitors and its top 5 to 10 indirect and future competitors makes it easier for the firm to complete its competitive analysis grid. From this list, 2-3 direct competitors and 1 indirect and 1 future competitor should be analyzed in depth.

5.5. Sources of competitive intelligence

With a list of competitors in hand, the next step is to conduct a methodical analysis of their strengths and weaknesses. Why is this important? It is a widely accepted fact that a company achieves success through the assets, skills, and competitive advantages that it brings into the marketspace. An analysis of successful competitors should reveal these sources of prosperity and assist you in structuring your business idea. Searching for weaknesses not only provides insight into what others may be doing wrong, but reveals where opportunities for success may lie.

A competitor analysis grid is a valuable tool to compare competitors from a number of perspectives - company information, product/service information, customer information, and sources of competitive advantage. To complete a meaningful competitive analysis grid, a firm must first understand the strategies and behaviors of its competitors. The information that is gathered by a firm to learn about its competitors is called **competitive intelligence**. Obtaining sound competitive intelligence is not always a simple task.

If a competitor is a publicly traded firm, a description of the firm's business and its financial information is available through annual reports filed with the Securities and Exchange Commission (SEC) or such sources as competitors' websites, third-person analyses of other firms, discussions with suppliers and vendors who serve the market niche, dublications of the trade associations in which the companies are members, current customers of the competitors, industry conferences and trade shows, which are normally

sponsored by the relevant trade associations or speeches and reports by the executives of competitive firms. If one or more of the competitors is a private company, the task is more difficult, given that private companies are not required to divulge information to the public. There are a number of ways that a firm can ethically obtain information about its competitors. A sample of the most common techniques is shown in Table 5.2.

Table 5.2: Sources of competitive intelligence

Source	Description/Benefit
Attend conferences and trade shows	Participants talk about the latest trends in the industry and display their most current products.
Purchase competitors' products	Purchasing and using a competitor's products can provide insight into their benefits and shortcomings. The purchase process itself can provide data about how a competitor treats its customers.
Study competitors' websites and social media pages	Many companies put a lot of information on their websites, including product information and the latest news about the company. The same goes for a company's pages on social media outlets, such as Facebook and Twitter.
Set up Google e-mail alerts	Google e-mail alerts are updates of the latest Google results, including press releases, news articles, and blog posts, on any keywords of interest. you can set up e-mail alerts using your company's name or the name of a competitor.
Read industry-related books, magazines, websites, and blogs	Many of these sources contain articles or features that have information about competitors.
Talk to customers about what motivated them to buy your product as opposed to your competitor's product	Customers can provide a wealth of information about the advantages and disadvantages of competing products.

Source: Groom and David (2001)

5.6. Creating a Competitive Analysis Grid

Competitive analysis grid is a tool for organizing the information a firm collects about its competitors. It can help a firm see how it stacks up against its competitors, provide ideas for markets to pursue, and, perhaps most importantly, identify its primary sources of competitive advantage. To be a viable company, a new venture must have at least one clear competitive advantage over its major competitors.

Basically, a competitor analysis grid is a large table. In the first column of the table is a list of criteria used to identify differences and similarities in competitors, everything from directory information such as the URL to competitive strategy information such as how the business locks in suppliers or customers. In each of the other columns is the corresponding information about each of the competitors you are analyzing.

Next, designate one of the columns for your business and put in your company's information, as best is known at this time. This provides a useful comparison between your e-business and your competitors, telling you where your business is positioned in relation to other firms competing in your industry.

Table 5.3 provides an example of what a competitive analysis might look like for a bicycle shop in a tourist locale.

Table 5.3. Competitive Analysis Grid for Sid's Cycle Shop in Branson, Missouri

Key Characteristics	Sid's Cycle	City Cycle	Spoke Masters	Target
Strengths	Product knowledge, Repair service	Repair service	High quality, Top brands	Price, hours (open seven days per week and online)

Key Characteristics	Sid's Cycle	City Cycle	Spoke Masters	Target
Weaknesses	Limited selection	Poor customer service	Pricing, no entry-level products	Low-end quality, no repair facilities
Product Quality Level	Low-middle	Middle-high	High-end	Entry-level
Price Point	Middle	Middle-high	High price	Lowest price
Location of the business	Suburban strip-mall on busy highway	Outskirts of town on route 280	Downtown side street	Branson Mall
Promotion	Weekly ad in local newspaper, some radio and Internet/social media	Advertising in local paper during season, Internet/social media	Sponsors major bike race in area, Internet, social media	Advertises online and in Sunday newspaper (seasonally), Internet)

Source: Laverty et al., 2020

5.7. Benchmarking

Another useful analytical tool used to determine whether a firm's value chain activities are competitive in comparison to those of its rivals is benchmarking. The benchmarking process entails attempting to measure the actual cost and efficiency of each component in the value chain in an attempt to identify specific superior actions or tactics, which are then termed best practices. Benchmarking involves the entrepreneur using the same sources of

information employed in the competitive intelligence process. Competition requires that every firm continually search for improved operational technologies and methods that will achieve lower cost, superior performance, or both.

Competitive benchmarking must provide a snapshot of the current competitive landscape, but it is up to the business to determine the depth of analysis that is required. Typically, worthwhile information about competitors includes: commercial information and financial information.

Commercial information: lines of business, core products and services and, if possible, their prices, key sales and distribution channels, major customers.

Financial information: revenue and profitability, levels of capex investment and return on capital employed.

The frequency with which you undertake competitor analysis will inherently vary depending on the nature of your business and the goals that you set. It is therefore up to each business to determine this frequency, whether it is monthly or several times daily. Nonetheless, competitor analysis should never be undertaken on a one-off basis, but needs to be a continuous activity that constitutes a business process in its own right, just like recruiting or sales.

Review Questions

1. In Porter's Five Forces, the 'threat of new entrants' relates to:

Barriers to entry

a. Substitutes

b. Switching costs

c. Buyer power

2. Barriers to entry into an industry are likely to be high if:

a. Switching costs are low

b. Differentiation is low

c. Requirement for economies of scale is high

d. Access to distribution channels is high

3. Buyer power is high if:

a. Differentiation is low

b. Switching costs are low.

c. They have little information

d. The buyer requires a high quality product for their own production

4. Supplier power will be high if:

a. The supplier's product is easy to understand

b. There are many suppliers to choose from

c. There is a threat of forward integration

d. The supplier's product is undifferentiated

5. A substitute product or service is:

a. A competitor's product or service

b. An alternative way of meeting the same need

c. A new entrant into the industry

d. A less attractive way of meeting the same need

6. Competitive rivalry will be high if:

a. The industry is fragmented

b. There are a few strong players in the industry

c. There is a high degree of differentiation

d. The industry is in its infancy

7. What is the main purpose of Porter's Five Forces Model?

a. Inform investment appraisal decisions

b. Analyse competition in a market

c. Manage product portfolios

d. Decide which products to launch

8. Can you identify which of the following forces does not form part of Porter's Competitive Position Analysis?

a. Buyer power

b. Risk of losses

c. Threat of new entry

d. Competitive rivalry

9. Robert has recently been appointed Marketing Manager for a fashion company. He needs to know whether or not the company's products have a sustainable advantage in the marketplace. What kind of analysis does he need to do?

a. environmental analysis

b. gap analysis

c. competitor analysis

d. market share/market growth analysis

CHAPTER 6: BUSINESS PLAN - TEMPLATE FOR A NEW VENTURE

Abstract:

This chapter provides an introductory overview about a business plan. A business plan can make or break a small business. A strong, detailed plan provides a clear road map for the future, forces you to think through the validity of a business idea, and can give you much greater understanding of the business's financials and the competition. In a successful company business and strategic situations are thought about continually and decisions are made early enough in order to act successfully within the market.

LEARNING OBJECTIVES

By the end of this chapter, students will be able to:

1. Understand the business and the importance of writing the business plan
2. Identify marketplace opportunities
3. Define the strategy and Implementation
4. Describe the management strategy
5. Describe the financial plan

CASE STUDY: Poor Planning, Big Problems: The Tale Of Tom Poor

"All those years of work are thrown away. To ease your mind is that all you can say? But what about that grandson on your knee? The railroad songs, Tom would sing to me." -Robert Plant

Many business owners dedicate decades to making their businesses successful. Far fewer owners plan for how they and their businesses will maintain success once they leave them (by choice, death, or otherwise).

Without a complete, robust plan, you may not get the outcomes you want or deserve once you inevitably exit your business. Consider the example of Tom Poor, a fictional but representative business owner whose failure to plan led to poor consequences.

The Tale of Tom Poor

Tom Poor always vowed to never live up to his namesake. The seventh son of an ironworker, Tom spent years building his successful steel manufacturing company. His success allowed him to provide a lifestyle for his wife and two children that no one in the Poor family had ever had. His company employed 135 people, and his two children were taking on more responsibilities at the company as Tom got older.

Just before Tom's 70th birthday, he made a startling announcement to his family and company. A large steel conglomerate had offered him $15 million for his company, and he verbally accepted the offer. He assured his employees and children that their jobs were safe based on a handshake agreement he'd made with the buyer. He assumed that $15 million was more than enough to allow him a comfortable lifestyle since his $500,000 salary and benefits package had provided so much for his family to that point.

Before the deal went through, Tom's children told him that they had expected to run the company once he left. They'd been training hard to prepare, and so the sale to an outside party shocked and upset them.

"I built this business into what it is today," Tom told them. "I've earned the right to make this decision because my decision-making got us here. Besides, I want to see the grandkids more." As the sale date approached, both of Tom's children quit to start their own venture together in a related business. When the buyer learned that two key employees were leaving, they told Tom that he would either have to replace them or accept a lower offer. Tom refused to accept a lower offer, but the employees he promoted to fill his children's roles were incapable of running the business.

As Tom tried to renegotiate, his employees began leaving the company one by one, citing low morale and a lack of commitment from Tom.

The original buyer pulled the offer. Though Tom managed to keep some employees from leaving, the exodus caused company production and value to plummet. His children refused to talk to him or let him see his grandchildren. His wife - heartbroken by what had happened - took their side.

Tom ended up selling the business at age 75 for $3 million. After taxes, he took home just over $1 million. With his family refusing to talk to him and barely enough to survive on his own after a year of poor health, Tom was forced to re-enter the workforce at the company he had sold just a year earlier.

Despite his promises to himself, Tom Poor ended his life living up to his namesake.

Strong Exit Planning Can Help Owners Avoid This Fate

Planning a successful business exit requires different skills than running a successful business. While Tom was a great business owner, he failed to think about what drove business value and what he needed to pursue a successful post-exit life. Consider some of the things Tom neglected to think about:

What he needed for financial security:

Tom simply assumed that $15 million would be enough for him and his family once he left. He was so committed to this assumption that he neglected to see what a big role his children played in achieving financial success and security. Proper planning could have shone light on what the business was worth, the factors that made the business more valuable, and the amount he actually needed to continue being comfortable and protect what he had built.

The fallout of his family's reaction:

Tom completely disregarded his children's commitment and desire to run the company. That not only led to the company's downfall but also prevented Tom from his goal of seeing his grandchildren more often. Comprehensive planning could have helped Tom understand his children's contributions and how to leverage them, which could have prevented the fallout caused by his lack of consideration.

What kind of legacy he'd leave:

Tom assumed that everyone would welcome his decision to sell the company. Obviously, that wasn't true. By working through his planning, starting with setting specific and objective goals, Tom could have better considered his legacy and involved his family and employees in the plan differently.

The consequences of a failed sale:

Adding salt to the wound, Tom's failure to sell the first time was a black mark on the company. When he finally found another buyer, they were only willing to pay a fraction of the original offer price. Because Tom wasn't prepared for a third-party sale, he suffered financially.

Conclusion

Without a clear, comprehensive, written plan, business owners have little control over their future. Had Tom properly prioritized his goals and planned for all aspects of his company's future, it's less likely he would have lost everything that mattered to him**.**

Source: WilmingtonBiz Insights, 2021
http://www.wilmingtonbiz.com/insights/dallas__romanowski/poor_planning_big_problems_the_tale_of_tom_poor/2953

Questions:

1. Why do you need a business plan ?

2. What are elements of a business plan?

6.1. Introduction to business planning

6.1.1. Definition of a business plan

A business plan, in principle, can be seen as a document that commercializes the business idea as a whole towards potential investors and stake- holders. A business plan is successful if you succeed in conveying to the reader the most significant opportunities and growth capacities of the company realistically.

A business plan should justify and describe the business idea and further business development in a clear and adequate manner. It should not merely aim at emphasizing the strengths of the company, but rather at presenting a realistic portrait of its problems, risks and obstacles. In addition to this, appropriate solutions should be proposed and discussed in detail.

6.1.2. The importance of the business plan

A business plan can be used for specific purposes. One target might be to obtain new means of investment for the development of a product or the marketing of a new product.

Basically a successful business plan has three important features:

- The short- and long-term objectives are clearly depicted,
- A careful description is given of how the objectives can be achieved in realistic general conditions and
- A description is given of how the realization of the plan will meet the expectations of the investors.

6.1.3 Who use the business plans

It is very important to clarify beforehand what purpose a business plan will serve and what it aims at. In general business plans are compiled either for an external or internal reason..

6.1.3.1 External Users

From an external point of view the business plan represents the main financing tool of the company. In addition, it serves to secure existing or planned business relations between the company and the stakeholders.

There are some groups of external users :

- Venture-capital financing
- Financing by bank credits
- Strategic alliances
- Mergers and acquisitions
- Customer and marketing relations

6.1.3.2 Internal Users

A business plan also serves as a valuable management tool from an internal viewpoint of the company. A systematically elaborated and regularly updated business plan, with a profound insight into all business matters, helps the management to efficiently plan the company's development and prepare the necessary modification measures in a structured way. Such a business plan can serve as a guide to the daily decision-making and as a control tool in managing the current business.

The joint realization of the business plan by the management team ensures an overall commitment to the company goals and controls. Achieving this commitment on the management level is most significant for the successful implementation of the plan.

Business plans make a significant contribution to the development of companies which have branches in different locations. By using business plans for each branch, the top management can on the one hand guarantee site-related business planning and on the other hand, continually control performance as well as the attainment of the business objectives. Furthermore, the long-term objectives of the entire company can be balanced by these indicators

***6.1.4 Basic* types of business plans**

For the majority of authors writing their first business plan, the question arises "How detailed should the business plan be?" To this question there is, unfortunately, no standard answer and no formula.

It is entirely up to you how detailed the business plan should be, and depends solely on the purpose and necessity behind it, as well as on the complexity of the specific business. In general, one distinguishes be- tween three basic types of business plans:

- the short business plan,
- the extended business plan and
- the operational business plan.
- In the following these three types are described.

6.1.4.1 Short business plan

A short business plan is usually about 10 to 15 pages long. It is most suitable for young companies in an early stage of their development when, there still do not exist complex interrelations.

For a well-established company, a short business plan only makes sense if certain investment opportunities are to be roughly approved in advance, in order to prepare an extended business plan on the base of the short ver- sion later on.

Even if it is a "short" business plan, the required information should be conveyed in a complete and appropriate manner. The final goal is to con- vince potential investors that you understand the entrepreneurial business and the market extremely well.

6.1.4.2 Extended business plan

The extended business plan is usually about 20 to 40 pages long. This type of business plan describes the business issues of the company much more profoundly and more detailed than a short business plan would do.

The higher the required capital, the more interesting this type of business plan becomes. If, for example, you require 5 million Euros outside capital for the construction of a new and innovative industrial plant, i.e. you are striving for long-term credits, the preparation of an extended busi-ness plan would be advisable.

Such a business plan should contain a thorough market analysis and a revenue, cost and financial planning for a 5-year period.

6.1.4.3 Operational business plan

For well-established companies a business plan can serve the management team as an important operative tool, say a business guideline. Such a plan not only serves as a draft for the entire business organization, but also ensures a consistent appreciation on the part of the entire management with respect to the strategic objectives. Indeed, operational business plans are very long and detailed, usually comprising over 40 pages, in some cases even exceeding 100 pages

6.2. What to include in the business plan

6.2.2. Marketing and Sale

The marketing strategy describes the market objective and marketing goals for the Future. Furthermore, it should determine the market share which the manager wish to achieve in the target market with the particular prod- uct portfolio, as well as the average market growth. People will have to plan the advertising and marketing costs accordingly.

When formulating the marketing strategy you should consider care- fully which pricing the company wish to embark from the customers. From the individual market segments, people can derive segment specific strategies. Thereby example,. industrial customers, commercial customers or end users are treated differently, according to the following criteria:

- Advertising and marketing media
- Services and auxiliary services
- Competitive orientation
- Customer profitability
- Customer loyalty
- Acquisition of new customers.

Based on the marketing strategy the operative measures are derivated and provided with appropriate budgets. This is the subject of the marketing plan which represents one of the most crucial management tools.

6.2.2.1 Marketing Plan

The business plan should include at least a three-year marketing plan, which sums up the sales targets for each product and product line (1,2,3, etc…), explains the core marketing measures and their risks and which also contains a timeline of planned product launches as well as a reason- able allocation of marketing costs.

The marketing plan thus represents a roadmap of the marketing activities which are necessary in order to achieve the strategic marketing goals.

Table 6. 1. Sample roadmap for sales activities.

Measures /activities	Date		Responsible
Activity	**Start**	**End**	
Sales campaign for product 1 - direct marketing			
Sales campaign for product 1 - E-Mail			
E-Mail campaign for the accessory of product 1			
Telephone campaign for the accessory of product 1			
Event for product 2			
E-Mail campaign for product 3			
E-Mail campaign for the accessory of product 1			
E-Mail campaign for product 2			

The marketing plan should above that also include the development of the market share with regard to the competitors as well as the analysis of main market trends.

6.2.2.2 Pricing policy

A key to the success of the business is the appropriate pricing policy. Every investor will ask the shopkeeper or the owners , according to which criteria the business arrange the prices. If the prices are too high, the company will not be able to attract customers and expect orders within the competitive environment. If the prices are too low, the company will risk steering the company into the loss area.

Table 6.2. Sample sheet for overall product planning

	LY*	CY*	PY*		
			1	2	3
Product / product group 1					
Market share (%)					
Market volume					
Percentage of sales (%)					
Sales Volume (quantity)					
Revenue					
Marketing costs					
Advertising costs					
Product performance					
Product / product group…					
Market share (%)					
Market volume					
Percentage of sales [%)					
Sales Volume (quantity)					
Revenue					
Marketing costs					
Advertising costs					
Product performance					
Total					
Total marketing costs					
Total advertising costs					
Overall result					

* LY: Previous year; CY: Current year; PY: Plan year

6.2.2.3 Advertising and sales promotion

The significance and the kind of advertising and sales promotion vary strongly among markets.

It has to be carried out a planning of advertising for consumer goods, that are bought regularly (e.g. foods and toiletries), for over-the-counter- drugs and for durable consumer goods. This plan has to include the main advertising message and budget, the selection of advertising media (television, journals, daily papers and so forth) as well as possible cooperation with advertising, sales promotion and public relation agencies. The se- lection and suitability of advertising media are mainly determined by the advertising goals as well as by geographical, quantitative and qualitative access to the target customers (generations, income levels, residence etc.).

The annual media analysis helps by displaying the audiovisual habits and literacy as well as the media coverage.

Sales promotion in the field of consumer business should be planned extremely carefully, in order to ensure their acceptance with the retailers, as well as their sales potential and success.

In mid-size companies, that do not produce a branded product for the final consumer, but semi-finished, preliminary products or components for other companies, advertising and sales promotion are mainly restricted to brochures, fairs and public relation campaigns.

6.2.2.4 Marketing organization

Marketing objectives are usually regarded as top priority. Thus either the entrepreneur himself or the marketing manager will take care of them. If marketing exists as an organizational unit, it often concerns a staff unit for producing brochures, organizing sales promotion and managing fairs. Du- ties and responsibilities which are perceived by product managers are not carried out in these staff units.

If the company provides several product lines for different target groups, it is wise to establish an independent product management

6.2.2.5. Sales

The sales strategy is based on the marketing strategy and turns it into operative sales objectives. The implementation of the sales strategy in the sales goals allows the development of the sales organization and the corresponding processes. On the one hand within the framework of a sales plan, the company should describe their current situation, on the other hand does it outline a roadmap which helps the company achieve their future goals and objectives. In the following this plan will discuss the basic issues of a sales organization and the basic elements of a sales plan.

6.2.2.6. Sales organization

As an entrepreneur you have to decide, how the company wish to approach the market, whether to build up their own sales team or for example work with sales representatives. The choice of the optimal sales method depends on the customers as well as on the relationship with them. A good relation- ship is needed for successful business.

When planning the sales organization payment plays a crucial role:

- How is the variable compensation structured?
- According to which criteria (increase of profit margins, turnover increase, new customer acquisition, etc.) do the plan the variable part of compensation?

6.2.2.7. Sales plan

The business plan should include a sales plan for at least three years, which summarizes sales targets according to markets and customers (1 to …), describes the basic sales activities with their risks along a timeline and contains a reasonable allocation of distribution expenses.

Basically the sales plan should capture following topics:

- planning of the sales,
- planning the customers and
- planning the sales area.

6.2.3. Research and Development

The future business potential of the company is mainly based on their innovations and development projects. Therefore the company should carefully pre- sent the research and development competences and the plans for new products and services in this business plan.

6.2.3.1 Presentation of research and development

Product design can only be successful if, on the one hand, one gets precise information about customer preferences and needs through marketing and if, on the other hand, the products are developed in close cooperation with the manufacturing department. Furthermore, marketing information is required about:

- the mega-trends of the markets,
- the achievable prices on the market and
- the required product differentiation for the different target groups

as well as an early cooperation with the purchasing department.

6.2.3.2 Development plan

The business plan should include at least a three-year research and development plan that summarizes the main research and development objectives, the main development projects and measures, as well as the related activities and risks. In addition to this, a time schedule for the planned launching of production and a wise distribution of the development costs should be included.

6.2.4 Production or Service

The business plan should include at least a three-year production plan which summarises the production or service strategy and contains a wise distribution of the production costs. It should show the relevant risks and the planned investments, and it should describe the essential measures for an increase in performance.

Table 6.3: Sample sheet for the records of production planning

Information	LY*	CY*	PY*		
			1	2	3
Production volume (quantity)					
Utilization of the capacity (%)					
Employees (number)					
Costs of material					
External services					
Personnel costs					
Depreciation					
Other production costs					
Total quality costs					
Total production costs					
Production costs / revenue (%)					

6.2.5 Financial Strategy

6.2.5.1 Presentation of financial situation

Financial management, as is carried out in a business plan, is essential for every company. The process of collecting the plan's data puts the management in a position that enables it to identify weak points as well as opportunities that present themselves more quickly.

The type of finances which have to be prepared for the business plan depends to a large extent on the development stage of the company, as well as, the goals the company want to achieve with the business plan. The longer a company has existed, the greater the expectations in this area are. If a company wishes to attain financing, the type and amount of the financing should generally be explained.

All these activities now have to flow into an economic number system which can be used to convince the current and potential investors of the entrepreneurial ability.

In order to do this it is very important to understand the financial data system and draw up planning aids in the form of spreadsheets very early on. Though the planning of finances is no witchcraft, it does require intensive analysis on the part. In this chapter we will pay close attention to this aspect and give you such planning aids to assist the company.

6.2.5.2 Financial Data System

The basic data can be classified into three categories:

- revenue,
- investments and
- costs.

The revenue is the evaluated amount of the products and services that the company sells. This data is taken from the sales and marketing plan.

The investments represent the capital required for production. This can include property, buildings, machinery as well as financial investments like shares, but also immaterial investments such as computer software.

The costs include all the remaining expenses which are necessary to keep the company running: salaries, wages, office supplies, information processing, telecommunication, etc.

On the basis of this information the company can create the balance sheet, in- come statement and cash-flow statement.

The balance sheet sums up the financial activities of their business at a key date - often coinciding with the end of the calendar year (Dec 31) - and provides the company and the investors with an insight into their overall financial position. While the assets show the application of funds (the assets that have utilized for the company), the liability shows the source of funds (equity and external funds).

The income statement (sometimes referred to as the profit and loss statement, the P&L) presents the results of your business activities. The sales

revenues of the products and services and all the related costs over the business year are reflected in this income statement, thus directly showing the investor their company's profitability.

The cash flow statement is especially important to the investors. It gives an idea about the company's self-financing potential, i.e. which means the company has at its disposal to pay dividends, taxes, loans and interest.

6.2.5.3 Analysis of Economic Development

Investors want to understand the current net asset position and the profitability of the company in order to gain confidence in the entrepreneurial abilities. Usually investors want to see the full set of financial statements of the last 3 years. Even more important for them are the planning documents the including balance sheets and income statements, as the investors can then better evaluate whether the company can operate with the given capital and whether the company can acquire an adequate income in the future that will result in lucrative returns for them.

Before dealing with the planning aspects the company must first analyse the existing financial situation of the company because its past development must reflect a solid basis for the future. Planning should not contradict future activities but should rather be based on past activities.

The equity ratio shows the percentage of equity in relation to total assets. In general, the higher the equity ratio is, the more financially stable and independent a company is.

The cash flow statement shows the financial strength. This statement gives information as to what extent the company has generated liquid as- sets. In this way the scope you have with internal financing can be estimated.

The return on total capital shows the productive efficiency of the company by relating the net income plus interest expense for the outside capital to the total capital (equity + liabilities). Hence it indicates the interest rate on the total capital.

The net debt to cash flow shows how many years a company will need to be able to completely repay its net liabilities from the cash flows of the company.

These analyses demand an intense and critical look at the current situation of the company and are the basis from which the company will develop in the future.

During the financial statement analysis you must also consider how the balance sheet will be presented. The use of the following different allow- able accounting policies can have a significant effect on your financial statements:

- Use of options for recognition and valuation,
- Selection of straight-line or declining balance methods,
- Valuation allowances and
- Provisions.

6.2.5.4 Company's Future Development

Determining the future potential of the company requires intense planning of all their entrepreneurial activities, which have been described in the preceding chapters. The estimation of the company's future earnings, as well as the strength of the balance sheet, will determine the probability that the company is able to pay back creditors, as well as obtaining future credit through loans and investments. A clear and consistent development from the past into the future is a prerequisite for qualified planning.

6.2.5.5 Sensitivity and risk analysis

The different risk groups:

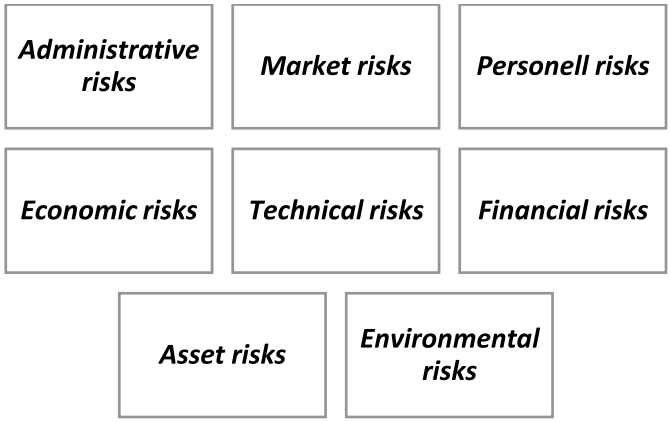

Figure 6.1 The different risk groups

Source: Morgan et al., 2016

For startups and established businesses, the ability to identify risks is a key part of strategic business planning. Risks are identified through a number of ways. Strategies to identify these risks rely on comprehensively analyzing a company's specific business activities. Most organizations face preventable, strategic and external threats that can be managed through acceptance, transfer, reduction, or elimination.

Example: The Business Plan Template

Executive Summary

1. My company name will be:_____

2. My business purpose is: _____

3. I plan to organize my company as (Corporation, Partnership, LLC, Other) _____

4. I have been in business since or plan on starting on:_____

5. Manager(s) for the company will be _____

6. My experience as an owner is: _____

Notes: _____

Products & Services

1. The products or services I sell are: _____

2. The features and benefits of what I'm selling are: _____

3. My products/services differ from my competition by: _____

4, What makes my product/services unique and desirable is: _____

5. Customers will buy from me because: _____

Notes: _____

The Industry, Competition & Market

1. I consider my competition to be: _____

2. How I will measure against the competition: _____

3. My local competitors are: _____

4. My national competitors are: _____

5. Some of the trends I see in my industry are: _____

6. Some potential areas I see for growth are: _____

7. My typical customers have these characteristics in common: _____

8. These segments of customers are under-served by competition: _____

Notes: _____

Marketing Plan

Marketing should address the four P's - Product, Price, Placement, and Promotion

1. My product or service is: _____

2. My pricing strategy is (For example: premium, every day, low price, frequent sales): _____

3. The places I will sell my product or service are: _____

4. I will promote my product or service by: _____

5. My competitive advantage is: _____

6. I can add value or compete on the following non-price issues: _____

7. I will distribute my product or service by: _____

8. My use of advertising will consist of: _____

9. I will get feedback from my customers by: _____

Notes: _____

Operating Plan

1. The location of my business is: _____

2. My hours of operation will be: _____

3. This is a good location for my business because: _____

4. I will be involved with the business by completing the following duties: _____

5. The equipment/furniture/fixtures _____

I need for my business would include: _____

6. If I need to hire new employees, I will need to hire for these new positions: _____

7. I will provide the following benefits to my employees: _____

8. I will recruit my employees by or from: _____

9. My suppliers and vendors are: _____

10. My cybersecurity and information management plans are: _____

11. Changes I'm considering for the business (if purchasing an existing business):

Notes: _____

Management & Ownership

The owners of my company are:

I have included resumes for the following key management personnel:

My attorney is:

My accountant is:

Other professionals that I will use are (accountant, banker, insurance agent, engineer, consultant, etc.):

Notes: _____

SWOT Analysis

1. The strengths of my business are (internal characteristics): _____

2. The weaknesses of my business are (internal characteristics): _____

3. I see the following opportunities for my business (external characteristics):

_____

4. I see the following threats/challenges for my business (external characteristics):

_____

Financials

1. The total investment required is:

_____

2. The collateral I can use for financing includes:

_____

3. My credit history is:

_____

4. My credit score is: _____

5. If I am short on money for my project, I can get more from: _____

6. My bank is, or the banks I would like to work with are:

_____

Review Questions

1. What is a business plan?

2. What are the advantages of preparing a business plan for a new venture?

3. When is the appropriate time to write a business plan?

4. What are the two primary reasons for those starting a new venture to write a business plan?

5. It is often argued that the process of writing a business plan is as important as the plan itself, particularly for the top management team of a young firm. Why is this so?

6. Who reads the business plan and what are they looking for when doing so?

7. How will investors typically react if they think a business plan is based on estimates and predictions rather than on careful analysis and facts?

CHAPTER 7. ETHICAL AND LEGAL ASPECTS OF A NEW VENTURE

Abstract:

The system of moral and ethical beliefs that guides the values, behaviors, and decisions of a business organization and the individuals within that organization is known as business ethics. Some ethical requirements for businesses are codified into law; environmental regulations, the minimum wage, and restrictions against insider trading and collusion are all examples of the government setting forth minimum standards for business ethics. This chapter will begin with a discussion of the most important initial ethical and legal issues facing a new firm, including establishing a strong ethical organizational culture, choosing a lawyer, drafting a founders' agreement, and avoiding litigation. This will be followed by the identification of the licenses and permits that may be needed to launch a business, along with the different forms of business organization, including sole proprietorships, partnerships, corporations, and limited liability companies.

Learning Objectives

By the end of this chapter, students will be able to:

1. Describe how to establish a strong ethical culture in their entrepreneurial ventures.
2. Discuss the importance of having a code of conduct and an ethics training program
3. Distinguish among sole proprietorships, partnerships, corporations, and limited liability companies.

Case study: Pfizer's IPR Battles in China for Viagra

In November 2006, the Bangbu Intermediate People's Court in the Anhui Province of the People's Republic of China (China) sentenced a Chinese man, Xi Yongli (Yongli), to eight years in prison for producing and selling counterfeits of Viagra, a drug for erectile dysfunction4 (ED), developed by the world's largest pharmaceutical company, Pfizer Inc. (Pfizer).

In December 2006, a Beijing court upheld Pfizer's Chinese patent for Viagra and ordered two Chinese companies to stop making generic versions of the drug and to pay compensation of 600,000 yuan (US$ 76,726) for infringing on the registered Analysts saw these incidents as some of the successes achieved by Pfizer in its efforts to thwart the challenge posed by manufacturers of generic and fake drugs in a country that was known to offer weak Intellectual Property Rights (IPR) protection.

Many also saw these rulings as an indication of China's increasing commitment to provide adequate IPR protection in order to conform to the Trade Related Intellectual-Property Rights (TRIPS) agreements.

Viagra is a widely popular drug and was considered as a great success story in marketing. It has raked in billions of dollars worldwide for Pfizer. Its success also made Viagra the most counterfeited drug in the world. However, its performance in China had been far below par. Ever since its launch in China in 2000, sales of Viagra had failed to take off in the world's most populated country. This was despite the fact that China had a huge market for drugs that enhanced sexual performance.

In late 2001, Pfizer was granted a patent for Viagra in China. But Pfizer soon became engaged in numerous patent litigations. An alliance of Chinese pharmaceutical companies petitioned the State Intellectual Property Office's (SIPO) Patent Re-examination Board (PRB) to invalidate the patent. They contended that Viagra should not be provided a patent as it failed to fulfill the "novelty" requirement under China's patent law. In July 4, 2004, PRB invalidated Pfizer's patent for Viagra citing that it had failed to accurately explain the uses of the Viagra's key ingredient, Sildenafil citrate (Sildenafil). Pfizer argued that at the time of filing of the patent application, there was no

requirement for that data, and to invalidate the patent on that basis was a flawed, "retroactive" judgement.

The invalidation of the patent led to a huge international outcry. Free trade supporters viewed this as an attack on IPRs of foreign companies and an indicator of China's reluctance to provide adequate protection to IPRs.

Critics lambasted China for failing to properly enforce IPR laws and called for political pressure to make China conform to TRIPS.

Roger Pilon (Pilon), vice president for legal affairs at the Cato Institute, explained the reason for the outcry: "On average, from the time a company first applies for a patent, it takes 12 to 15 years and $800 million before the first pill reaches the market. Obviously, if others were free to copy and sell that pill, having incurred none of those costs, there would be no incentive to make that kind of investment - and none of the modern "miracle" drugs that investment produces. No one grows crops if others are free to harvest them."

However, some analysts felt that there were significant positives relating to the litigation. It showed that Chinese companies had begun to appreciate the importance of IPRs. The decision of these companies to take legal recourse rather than infringing on the IPRs was appreciated. It indicated that China was keen to project its transition to become fully compliant with the WTO agreements.

Background Note

Pfizer, the largest pharmaceutical company in the world, sold its products in more than 150 countries (Refer to Exhibit I for a brief note on Pfizer). In the early 1990s, Pfizer's scientists realized that a drug being developed by it to control hypertension was a potential drug to treat male impotence.

On May 13, 1994, Pfizer submitted an application for a patent called "Pyrazolopyrimidinones for the treatment of impotence" with China's SIPO. The same day, Pfizer submitted similar patent applications in the US Patent and Trademark Office and the European Patent Office.

trademark of Pfizer.

SIPO Invalidates Viagra's Patent

In May, 2004, Pfizer announced that it was partnering with the Chinese government to enforce its patent on Viagra that had been granted in 2001. But

on July 7, 2004, the SIPO revoked the patent. The alliance cited six alleged grounds for invalidity. Pfizer won on three and lost on one and two others remained undecided. The review board said that Pfizer was on the wrong side of the patent law as it had failed to accurately explain the uses of the Viagra's key ingredient, Sildenafil.

SIPO Ruling Leads to International Outcry

Due to the huge market potential for ED drugs and the dispute between local and foreign firms, the Viagra patent litigation issue generated a lot of interest around the world. The decision of SIPO to invalidate Pfizer's patent for Viagra led to an international outcry. They viewed the adverse ruling as an indication that China was unwilling to comply with the guidelines set by its membership in the WTO. Some accused it of regressing back to the past when IPRs were violated by Chinese firms while the Chinese government looked the other way.

Analysts See a Silver Lining

But some experts felt that the legal challenge to Viagra had a silver lining as it indicated the continuing development and progress of the Chinese IPR regime. The Chinese pharmaceutical companies' decision to legally challenge Pfizer's patent demonstrated significant progress by China toward the rule of law in the IPR arena. They noted that on earlier occasions Chinese firms had blatantly violated IPRs and this new emphasis on seeking legal routes was indicative of the Chinese companies' growing appreciation of the value of patent laws.

China's Huge Market can't be Ignored

Analysts did not read too much into Pfizer and other MNC pharmaceutical companies' assertion that the ruling against Pfizer would lead to decreased investment in China. China continues to be an attractive market for multinational pharmaceutical companies. Alan Adcock, senior associate Rouse & Co. International said that the Chinese pharmaceutical market was "too attractive" for the foreign players to ignore.

Pfizer's Viagra Patent Restored

In late 2004, Pfizer sued SIPO's PRB for wrongfully invalidating its patent for Viagra. It appealed to the court to withdraw the PRB's decision. The

case was argued in March 2005. Pfizer's attorney, Tai Hong (Hong), argued before the court that Pfizer had provided the information that was needed for granting of the patent.

She said, "The decision made by the PRB had errors in facts and [was an] erroneous application of the law." Hong also argued that SIPO's decision violated the TRIPS agreements. She also hinted that the right decision was not reached because the attorney applying for invalidation of the patent, Xu Guowen, was a retired official with the PRB.

China Cracks Down on Counterfeiters

In November 2006, the Chinese government cracked down on Viagra counterfeiters. A Chinese man, Xi Yongli (Yongli), was jailed for eight years for producing 60 tonnes of fake pills for ED. It was alleged that Yongli and his accomplices had sold pills worth 21.8 million yuan ($3.6 million) under the names, America Number One, Male Exclusive, Great Big Brother.

Pfizer Loses Viagra Trademark Row

When Pfizer launched Viagra in China it could not use the popular Chinese equivalent brand name 'Wei Ge' as the name was already registered by Guangzhou Viaman Pharmaceutical Co. Ltd. (Viaman). Viaman had registered this brand name in 1998, when Pfizer launched Viagra in the US. Viaman produced another ED drug by the name 'Wei Ge' containing the ingredient Phentolamine mesylate.

Outlook

Experts felt that the Chinese patent law and its market had matured considerably in a relatively short span of time. However, they felt that China still was lagging behind in providing a credible patent enforcement system. Experts were not too optimistic about the impact of the ruling on Viagra's global sales. Even with exclusive rights, Viagra's sales in China was not expected to change Viagra's global sales significantly as the brand was facing worldwide decline in sales and tough competition from Levitra and especially Cialis.

Questions:

1. *What do you think about the pfizer battle for getting patented viagra?*
2. *Do you think law of patent should vary with regard to countries?*

7.1. Establishing a Strong Ethical Culture for a firm

Ethics are a set of standards that govern the conduct of a person, especially a member of a profession. While ethical beliefs are held by individuals, they can also be reflected in the values, practices, and policies that shape the choices made by decision makers on behalf of their organizations. Professions and organizations regularly establish a "Code of Ethics" that serves to guide the behavior of members of the profession or organization. In the medical profession, for instance, doctors take an ethical oath to "do no harm." The American Society of Mechanical Engineers' code states, "Engineers shall hold paramount the safety, health, and welfare of the public in the performance of their professional duties." A striking example of industry-specific business ethics is in the energy field. Companies that produce energy, particularly nonrenewable energy, face unrelenting scrutiny on how they treat the environment. One misstep-whether it is a minor coal ash spill at a power plant or a major disaster such as the 2010 BP (BP) oil spill-forces a company to answer to numerous regulatory bodies and society at large regarding whether it skirted its duty to protect the environment in an aggressive pursuit of higher profits.

One of the most important things the founders of an entrepreneurial venture can do is establish a strong ethical culture for their firms. A business's culture is often seen as something abstract and difficult to quantify. It goes beyond the employee handbook and the company's mission statement. A business culture is the method in which the company functions. The business culture can include how employees dress for work, how they interact with management and how they interact with customers and clients.

To define an ethical business culture for a business is to create an environment where doing the right thing is easy and doing the wrong thing will get you disciplined or fired. It also means involving employees in regular discussions about workplace ethics and the procedures that are designed to uphold ethical practices.

An ethical business culture also places a high value on fairness, employee rights, and equal pay, while also discouraging dishonesty, unpaid

wages, discrimination and disloyalty to the company, its employees, and its customers. The following are specific steps that an entrepreneurial organization can take to build a strong ethical culture.

7.1.1. Leading by example

Leading by example is the most important thing that any entrepreneur, man-ager, or supervisor can do to build a strong ethical culture in their organization. In strong ethical cultures, entrepreneurs, managers, and supervisors:

- Communicate ethics as a priority
- Set a good example of ethical conduct
- Keep commitments
- Provide information about what is going on
- Support following organizational standards

Employees also have responsibilities. The most important things that employees can do to support a strong ethical culture in an organization are to:

- Consider ethics in making decisions
- Talk about ethics in the work (they) do
- Set a good example of ethical conduct
- Support following organizational standards

In companies where these attributes are present, a stronger ethical culture exists. This reality demonstrates the important role that everyone involved with a start-up plays in developing a strong ethical culture for their firm.

7.1.2. Establishing a Code of Conduct

A strong code of conduct offers real value to a company. Developing and sustaining such a code occurs through a broad-based, managed process that includes attention to the organization's mission, values and other key considerations. The advantage of having a code of conduct is that it provides specific guidance to entrepreneurs, managers, and employees regarding expectations of them in terms of ethical behaviour. A well-developed code can help a company to prevent legal and regulatory violations, Foster greater

employee loyalty and retention, Encourage greater customer loyalty and retention, and Strengthen trust and respect of other stakeholders, such as local communities, regulators, NGOs, even from competitors. With a little foresight and focus, a company can develop a new code or enhance an existing code to reap the numerous benefits it can provide.

Chief among these standards are the ethics and compliance risks that a company seeks to prevent, detect and mitigate, should a violation occur. Many companies make their codes available to outside stakeholders and may even use them as a way to set expectations for the organization's business partners. Further, with the role that it plays within an ethics and compliance program, the code of conduct can set the stage for the program's future success or, alternatively, get the program off to a poor start.

In practice, some codes of conduct are very specific, like Google's. Other codes of conduct set out more general principles about an organization's beliefs on issues such as product quality, respect for customers and employees, and social responsibility. In all cases though, codes of conduct are intended to influence people to behave in ways that are consistent with a firm's ethical orientation.

7.1.3. Implement an Ethics Training Program

Firms also use ethics training programs to promote ethical behaviour. An ethics program helps communicate the company's business philosophy to employees, vendors, investors and customers. A good ethics program can help strengthen the company's relationships with employees and customers and improve reputation.

Ethics training programs can be provided by outside vendors or can be developed in-house. For example, one organization, Character Training International (CTI), provides ethics training programs for both large organizations and smaller entrepreneurial firms. The company offers a variety of ethics-related training services, including ethics training videos/DVD programs, ethics online courses, train-the-trainer curriculum, and consulting

services. A distinctive attribute of CTI is its focus on the moral and ethical roots of workplace behavior. In workshops, participants talk about the reasons behind ethical dilemmas and are provided practical, helpful information about how to prevent problems and how to deal appropriately with the ethical problems and temptations that do arise. The hope is that this training will significantly cut down on employee misconduct and fraud and will increase morale.

7.2. Legal Behaviour

Legal behaviour follows the dictates of laws, which are written down and interpreted by the courts. In decision making, determining the legality of a course of action is facilitated by the existence of statutes, regulations, and codes. Unlike ethical considerations, there are established penalties for behaving in a way that conflicts with the law. However, as society evolves, what constitutes legal behavior also changes. For example, until recently, the possession or use of marijuana was illegal in the State of Colorado. As a result of the legislation that legalized marijuana, existing laws will need to be reinterpreted, and undoubtedly additional laws will be enacted to govern what was formerly illegal behaviour. Whether or not an individual thinks it is ethical to use a potentially harmful substance, the fact is that the law now allows such behaviour.

Those leading entrepreneurial ventures can also expect to encounter a number of important legal issues when launching and then, at least initially, operating their firm. Here are a number of these issues faced by entrepreneurs:

7.2.1. Choosing an Attorney for a Firm

It is important for an entrepreneur to select an attorney as early as possible when developing a business venture. It is critically important that the attorney be familiar with start-up issues and that he or she has successfully shepherded entrepreneurs through the start-up process before. It is not wise to select an attorney just because she is a friend or because you were pleased with the way she prepared your will. For issues dealing with intellectual property

protection, it is essential to use an attorney who specializes in this field; such as a patent attorney when filing a patent application.

While hiring an attorney is advisable, it is not the only option available for researching, preparing, and filing the necessary forms to get a business up and running legally. Most business owners can do much of the preliminary work on their own, and they rely on an attorney for guidance and advice. If you're particularly tight on money and feel as though you can handle portions of the legal process on your own (which is not generally recommended but may apply in some cases), there are online companies that can help you with the necessary forms and filings. Examples include LegalZoom (www.legalzoom.com), Rocket Lawyer (www.rocketlawyer.com), and Nolo (www.nolo. com). A blended approach might involve hiring an attorney to obtain legal advice (such as determining your form of business ownership) and then utilizing one of the online services to prepare the documents and file them with the appropriate governmental agencies on your behalf.

7.2.2. Drafting a Founder's Agreement

If two or more people start a business, it is important that they have a founders' (or shareholders') agreement. A founders' agreement is a written document that deals with issues such as the relative split of the equity among the founders of the firm, how individual founders will be compensated for the cash or the effort they put into the firm, and how long the founders will have to remain with the firm. It is a legally binding contract and should be created at the beginning of the company's lifecycle, in order to get everything out on the table before a group of co-founders jumps in together.

An important issue addressed by most founders' agreements is what happens to the equity of a founder if the founder dies or decides to leave the firm. Most founders' agreements include a buyback clause, which legally obligates departing founders to sell to the remaining founders their interest in the firm if the remaining founders are interested. In most cases, the agreement also specifies the formula for computing the dollar value to be paid. The

presence of a buyback clause is important for at least two reasons. First, if a founder leaves the firm, the remaining founders may need the shares to offer to a replacement person. Second, if founders leave because they are disgruntled, the buyback clause provides the remaining founders a mechanism to keep the shares of the firm in the hands of people who are fully committed to a positive future for the venture.

Vesting ownership in company stock is another topic most founders' agreements address. The idea behind vesting is that when a firm is launched, instead of issuing stock outright to the founder or founders, it is distributed over a period of time, typically three to four years, as the founder or founders "earn" the stock. Not only does vesting keep employees motivated and engaged, but it also solves a host of potential problems that can result if employees are given their stock all at once.

7.2.3. Avoiding Legal Disputes

Most legal disputes are the result of misunderstandings, sloppiness, or a simple lack of knowledge of the law. Getting bogged down in legal disputes is something that an entrepreneur should work hard to avoid. It is important early in the life of a new business to establish practices and procedures to help avoid legal disputes. Legal snafus, particularly if they are coupled with management mistakes, can be extremely damaging to a new firm.

7.2.4. Setting Standards

Organizations should also set standards that govern employees' behavior beyond what can be expressed via a code of conduct. For example, four of the most common ethical problem areas that occur in an organization are human resource ethical problems, conflicts of interest, customer confidence, and inappropriate use of corporate resources. Policies and procedures should be established to deal with these issues.

When legal disputes do occur, they can often be settled through negotiation or mediation, rather than more expensive and potentially damaging litigation. Mediation is a process in which an impartial third party (usually a professional mediator) helps those involved in a dispute reach an agreement.

7.2.5. Obtaining Business Licenses and Permits

Many businesses require licenses and permits to operate. Depending on the nature of the business, licenses and permits may be required at the federal, state, and/or local levels. There are three ways for those leading a business to determine the licenses and permits that are necessary. The first is to ask someone who is running a similar business, and they will usually be able to point you in the right direction. The second is to contact the secretary of state's office in the state where the business will be launched. In most cases, they'll be able to help you identify the federal, state, and local licenses that you'll need. The third is to use one of the search tools available online.

The number-one rule is that if you're uncertain, ask. Severe penalties can be levied if you start running a business without the proper licenses in place. The following is an overview of the licenses and permits that are required in the United States at the federal, state, and local levels for business organizations.

7.2.6. Choosing a Form of Business Organization

When a business is launched, a form of legal entity must be chosen. Sole proprietorships, partnerships, corporations, and limited liability companies are the most common legal entities from which entrepreneurs make a choice. Choosing a legal entity is not a one-time event. As a business grows and matures, it is necessary to periodically review whether the current form of business organization remains appropriate.

There is no single form of business organization that works best in all situations. It is up to the owners of a firm and their attorney to select the legal entity that best meets their needs. It is important to be careful in selecting a legal entity for a new firm because each form of business organization involves trade-offs among these factors and because an entrepreneur wants to be sure to achieve the founders' specific objectives.

This section describes the four forms of business organization and discusses the advantages and disadvantages of each.

Figure 7.1: Corporate Structure Hierarchy

(Source: Barringer and Ireland, 2016)

- Sole Proprietorship

The sole proprietorship is the simplest business form under which one can operate a business. The sole proprietorship is not a legal entity. It simply refers to a person who owns the business and is personally responsible for its debts. A sole proprietorship can operate under the name of its owner or it can do business under a fictitious name, such as 1800 Flowers shop. Many sole proprietors do business under their own names because creating a separate business or trade name isn't necessary.

Advantages of a Sole Proprietorship

Easy and inexpensive to form: Setting up a sole proprietorship is cheap and relatively easy compared to the other forms of business ownership. Costs are minimal, with legal costs limited to obtaining the necessary licenses or permits.

Complete control. Because you are the sole owner of the business, you have complete control over all decisions. You aren't required to consult with anyone else when you need to make decisions or want to make changes.

Easy tax preparation. Your business is not taxed separately, so it's easy to fulfill the tax reporting requirements for a sole proprietorship. The tax rates are also the lowest of the business structures. The profit or loss of the business flows through to the owner's personal tax return document and the business ends at the owner's death or loss of interest in the business.

Disadvantages of a Proprietorship

Unlimited personal liability. Because there is no legal separation between you and your business, you can be held personally liable for the debts and obligations of the business. This risk extends to any liabilities incurred as a result of employee actions.

Hard to raise money. Sole proprietors often face challenges when trying to raise money. You cannot sell stock in the business, which limits investor opportunity. Banks are also hesitant to lend to a sole proprietorship because of a perceived additional risk when it comes to repayment if the business fails. It is usually difficult for a sole proprietorship to raise investment capital because the ownership of the business cannot be shared.

Heavy burden. The flipside of complete control is the burden and pressure it can impose. The sole proprietor is responsible for all the liabilities of the business, and this is a significant drawback. If a sole proprietor's business is sued, the owner could theoretically lose all the business's assets along with personal assets.

Low liquidity. The liquidity of an owner's investment in a sole proprietorship is typically low. Liquidity is the ability to sell a business or other asset quickly at a price that is close to its market value

- Partnerships

A business partnership is a legal relationship that is most often formed by a written agreement between two or more individuals or companies. The partners invest their money in the business, and each partner benefits from any profits and sustains part of any losses. Few co-branding partnership examples include Red Bull and GoPro, Spotify and Uber, Levi's & Pinterest, Maruti Suzuki, and Hindustan Petroleum. Partnerships are organized as either general or limited partnerships.

General Partnerships: A general partnership is a form of business organization where two or more people pool their skills, abilities, and resources to run a business. Accordingly, this kind of partnership consists of partners who participate in the day-to-day operations of the partnership and who have liability as owners for debts and lawsuits. The primary advantage of a general partnership over a sole proprietorship is that the business isn't dependent on a single person for its survival and success. In fact, in most cases, the partners have equal say in how the business is run. Most partnerships have a partnership agreement, which is a legal document that is similar to a founders' agreement. A partnership agreement details the responsibilities and the ownership shares of the partners involved with an organization. The business created by a partnership ends at the death or withdrawal of a partner, unless otherwise stated in the partnership agreement. General partnerships are typically found in service industries. Similar to a sole proprietorship, the profit or loss of a general partnership flows through to the partner's personal tax returns. If a business has four general partners and they all have equal ownership in the business, then one-fourth of the profits or losses would flow through to each partner's individual tax return.

The primary disadvantage of a general partnership is that the individual partners are liable for all the partnership's debts and obligations. If one partner is negligent while conducting business on behalf of the partnership, all the partners may be liable for damages. Although the non-negligent partners may later try to recover their losses from the negligent one, the joint liability of all partners to the injured party remains. It is typically easier for a general

partnership to raise money than a sole proprietorship simply because more than one person is willing to assume liability for a loan. One way a general partnership can raise investment capital is by adding more partners. Investors are typically reluctant to sign on as general partners, however, because of the unlimited liability that follows each one. In summary, the primary advantages and disadvantages of a general partnership are as follows:

Advantages of a general Partnership

- Simple to set up.
- Minimal reporting requirements.
- Shared control and management with other partners.
- A partner's share of the business's tax losses may be offset against other personal income, subject to certain conditions.
- Relatively easy to dissolve the partnership.
- Partners are not employees. Superannuation contributions and workers' compensation insurance are not compulsory for partners.
- Easier to obtain finance as you are not relying on one person's income or assets.

Disadvantages of a general Partnership

- Liability on the part of each general partner is unlimited.
- The business relies on the skills and abilities of a fixed number of partners. Of course, similar to a sole proprietorship, the partners can hire employees who have additional skills and abilities.
- Raising capital can be difficult.
- The liquidity of each partner's investment is low.
- A partnership is not a separate legal entity. Partners are personally liable for the debts incurred by the partnership, meaning there is no asset protection.
- Potential for disputes over profit sharing, administrative control and business direction.
- Changes of ownership can be difficult and generally requires a new partnership to be established.

Limited Partnerships: A limited partnership is a modified form of a general partnership. Limited partnerships have only one general partner with unlimited liability, and all other partners have limited liability. The partners with limited liability also tend to have limited control over the company, which is documented in a partnership agreement. Profits are passed through to personal tax returns, and the general partner - the partner without limited liability - must also pay self-employment taxes.

A limited partnership is usually formed to raise money or to spread out the risk of a venture without forming a corporation. Limited partnerships are common in real estate development, oil and gas exploration, and motion picture ventures.

- Corporations

A corporation is a legal entity that is separate and distinct from its owners.1 Corporations enjoy most of the rights and responsibilities that individuals possess: they can enter contracts, loan and borrow money, sue and be sued, hire employees, own assets, and pay taxes. Corporations are organized as either C corporations or S corporations.

C Corporations:

A C corporation is a separate legal entity that, in the eyes of the law, is separate from its owners. In most cases, the corporation shields its owners, who are called shareholders, from personal liability for the debts and obligations of the corporation. A corporation is governed by a board of directors, which is elected by the shareholders. In most instances, the board hires officers to oversee the day-to-day management of the organization. It is usually easier for a corporation to raise investment capital than a sole proprietorship or a partnership because the shareholders are not liable beyond their investment in the firm. It is also easier to allocate partial ownership interests in a corporation through the distribution of stock. Most C corporations have two classes of stock: common and preferred. Preferred stock is typically issued to conservative investors who have preferential rights over common stockholders in regard to dividends and to the assets of the corporation in the event of liquidation. Common stock is issued more broadly than preferred stock. The

common stockholders have voting rights and elect the board of directors of the firm. The common stockholders are typically the last to get paid in the event of the liquidation of the corporation; that is, after the creditors and the preferred stockholders.

Advantages of C corporations

- A corporation is separate from its owners: Once formed, a corporation has a life of its own, with its own rights, capabilities, responsibilities, and liabilities. This means that it can buy, own, and use its own real or personal property, make its own contracts and guarantees, lend money and invest funds.
- A corporation offers owners limited liability protection: Because a corporation is a separate entity, its debts, obligations, and liabilities are it's own. The shareholders' exposure to loss is limited to the amount invested in the corporation.
- A corporation has a perpetual existence: Once a corporation is formed, it continues to exist until it is dissolved, wound up and liquidated, unless its articles of incorporation provide otherwise.
- Free transferability of shares: A shareholder can freely sell those shares and the buyer will become the shareholder with all of those rights. A member in an LLC can sell his or her economic rights but not the management rights.
- Corporations provide multiple tax planning opportunities: Operating as a corporation may involve additional complexity, but it also provides a wide array of tax planning opportunities across the business life cycle.

Disadvantages of A corporations

- Complexity: A corporation is more complex to operate than an LLC. The corporation laws require more formalities in how a corporation is managed. For example, shareholder and director meetings are required.
- Double taxation: A corporation is a separate tax-paying entity unless it makes an election to be taxed as an S corporation. This means a C corporation pays corporate income tax on its income, after offsetting income with losses, deductions, and credits. A corporation pays its shareholders dividends from its after-tax income. The shareholders then pay personal income taxes on the dividends.

S Corporation

S corporations are merely corporations that elect to pass corporate income, losses, deductions, and credit through to their shareholders for federal tax purposes. Like a C corporation, an S corporation is generally a corporation under the law of the state in which the entity is organized. For federal income tax purposes, however, taxation of S corporations resembles that of partnerships. Thus, income is taxed at the shareholder level and not at the corporate level. Payments to S shareholders by the corporation are distributed tax-free to the extent that the distributed earnings were not previously taxed. Also, certain corporate penalty taxes (e.g., accumulated earnings tax, personal holding company tax) and the alternative minimum tax do not apply to an S corporation. In order to make an election to be treated as an S corporation, the following requirements must be met:

- The business cannot be a subsidiary of another corporation.
- The shareholders must be U.S. citizens. Partnerships and C corporations may not own shares in a subchapter S corporation. Certain types of trusts and estates are eligible to own shares in a subchapter S corporation.
- It can have only one class of stock issued and outstanding (either preferred stock or common stock).
- It can have no more than 100 members. Husbands and wives count as one member, even if they own separate shares of stock. In some instances, family members count as one member.
- All shareholders must agree to have the corporation formed as a subchapter S corporation.

- Limited Liability Company

A limited liability company (LLC) is a business structure whereby the owners are not personally liable for the company's debts or liabilities. Limited liability companies are hybrid entities that combine the characteristics of a corporation with those of a partnership or sole proprietorship. As with partnerships and corporations, the profits of an LLC flow through to the tax returns of the owners and are not subject to double taxation. The main advantage of the LLC is that all partners enjoy limited liability. This differs

from regular and limited partnerships, where at least one partner is liable for the debts of the partnership. The LLC combines the limited liability advantage of the corporation with the tax advantages of the partnership.

Some of the terminology used for an LLC differs from the other forms of business ownership. For example, the shareholders of an LLC are called "members," and instead of owning stock, the members have "interests." The LLC is more flexible than a subchapter S corporation in terms of number of owners and tax-related issues. An LLC must be a private business-it cannot be publicly traded. If at some point the members want to take the business public and be listed on one of the major stock exchanges, it must be converted to a C corporation.

Although the requirements for LLCs may vary by state, there are generally some commonalities across the board. The very first thing owners or members must do is to choose a name. Once that is done, the articles of organization must be documented and filed with the state. These articles establish the rights, powers, duties, liabilities, and other obligations of each member of the LLC. Other information included on the documents includes the name and addresses of the LLC's members, the name of the LLC's registered agent, and the business' statement of purpose. The articles of organization must be accompanied by a fee paid directly to the state. Paperwork and additional fees must also be submitted at the federal level to obtain an employer identification number.

Advantages of LLCs

- Fewer corporate formalities: the members and managers of an LLC need not hold regular meetings, which reduces complications and paperwork.
- No ownership restrictions: S-corporations cannot have more than 100 stockholders, and each stockholder must be a natural person who is a resident or citizen of the United States. There are no such restrictions placed on an LLC.
- Ability to use the cash method of accounting: Unlike a C-corporation, which often must use the accrual method of accounting, most limited liability companies can use the cash method of accounting. This means that income is not earned until it is received.

• Ability to deduct losses: Members who are active participants in the business of an LLC are able to deduct its operating losses against the member's regular income to the extent permitted by law. Shareholders of an S-corporation are also able to deduct operating losses, but shareholders of a C-corporation are not.

• Tax flexibility: By default, LLCs are treated as a "pass-through" entity for tax purposes, much like a sole proprietorship or partnership. This means that LLCs avoid double taxation. Furthermore, an owner of an LLC is not required to pay unemployment insurance taxes on his or her own salary. However, an LLC can also elect to be treated like a corporation for tax purposes, whether as a C-corporation or an S-corporation.

Disadvantages of LLCs

• Profits subject to social security and medicare taxes: In some circumstances, owners of an LLC may end up paying more taxes than owners of a corporation.

• Owners must immediately recognize profits: Because an LLC is not subject to double-taxation, the profits of the LLC are automatically included in a member's income.

• Fewer fringe benefits: Employees of an LLC who receive fringe benefits, such as group insurance, medical reimbursement plans, medical insurance and parking, must treat these benefits as taxable income.

Review Questions

1. Which of the following statements is incorrect in relation to partnerships?

a. Unless otherwise agreed, property will be considered partnership property where it had been purchased with partnership money

b. Partners are held jointly and severally liable for the partnership debts

c. Partners must act in good faith

d. Partners are not agents of the organization

2. Which of the following is NOT a type of partnership structure?

a. An unlimited partnership

b. An extraordinary partnership

c. A limited partnership

d. A limited liability partnership

3. Which of the following is NOT a feature of a limited company?

a. The company's separate legal personality

b. The perpetual succession of the company

c. The limited liability of the members

d. The directors' immunity from any criminal sanctions

4. The simplest form of business ownership is a:

a. proprietorship

b. partnership

c. corporation

d. limited liability company

5. Which of the following is an advantage of a sole proprietorship?

a. ease of starting a business

b. being your own boss

c. pride of ownership

d. all of the above

6. The main disadvantage of a general partnership is:

a. the unlimited liability of the partners

b. disagreement amongst partners

c. shared management

d. difficulty of termination

7. A _____ is a business with two or more owners:

a. corporation

b. conglomerate

c. partnership

d. public corporation

8. Which of the following statements is correct for a sole proprietorship?

a. The sole proprietor has limited liability

b. The sole proprietor can easily dispose of their ownership position relative to a shareholder in a corporation

c. The sole proprietorship can be created more quickly than a corporation

d. The owner of a sole proprietorship faces double taxation unlike the partners in a partnership

9. Limited liability companies (LLCs) generally possess no more than two of the following four (desirable) characteristics: (1) limited liability, (2) centralized management, (3) unlimited life, and (4) the ability to transfer ownership interest without prior consent of the other owners. Which of the following forms of business organization in the U.S. generally possesses all four of these characteristics?

a. General partnership

b. Limited partnership

c. Corporation

d. None of the above

CHAPTER 8:
HUMAN RESOURCES AND NEW VENTURES

Abstract: In this chapter, we focus on how the founders of an entrepreneurial venture build a new-venture team as well as the importance of the team to the firm's overall success. Elements of a new venture team are also discussed and the roles of each new venture team element are presented.

Learning Objectives

By the end of this chapter, students will be able to:

1. Introduce concept of liability of newness.
2. Narrate the formation of a new-venture team.
3. Explain the importance of professional advisers.

8.1. Liability of newness

New ventures always have a high risk to fail. The high rate of failure is due in part to what is known as the liability of newness, which relates to the fact that companies often falter because the people who start them aren't able to adjust quickly enough to their new roles and because the firm lacks a "track record" with outside buyers and suppliers. Assembling a talented and experienced new-venture team is one path firms can take to overcome these limitations. Indeed, experienced management teams that get up to speed quickly are much less likely to make a novice's mistakes. In addition, firms able to persuade high-quality individuals to join them as directors or advisers quickly gain legitimacy with a variety of people, such as some of those

working inside the venture as well as some outside the venture (e.g., suppliers, customers, and investors). In turn, legitimacy opens doors that otherwise would be closed.

Another way entrepreneurs overcome the liability of newness is by attending entrepreneurship-focused workshops and events. These types of activities are sponsored by local universities, small business development centers, and economic development commissions. Another route to overcoming the liabilities of newness is joining one of the growing number of start-up accelerators that are popping up across the country. Start-up accelerators provide entrepreneurs access to mentors, investors, subject matter experts (such as attorneys and accountants), and other entrepreneurs. Entrepreneurs should remember that, at the end of the day, the faster they can overcome the liabilities associated with launching a new venture, the greater the likelihood they will achieve success with their firm.

8.2. Formation of a new-venture team

Those who launch or found an entrepreneurial venture have an important role to play in shaping the firm's business model. Stated even more directly, it is widely known that a well-conceived business plan, one that flows from the firm's previously established business model, cannot get off the ground unless a firm has the leaders and personnel to carry it out. As some experts put it, "People are the one factor in production … that animates all the others." Often, several start-ups develop what is essentially the same idea at the same time. When this happens, the key to success is not the idea but rather the ability of the initial founder or founders to assemble a team that can execute the idea better than anyone else.

The way a founder builds a new-venture team sends an important signal to potential investors, partners, and employees. Some founders like the feeling of control and are reluctant to involve themselves with partners or hire managers who are more experienced than they are. In contrast, other founders are keenly aware of their own limitations and work hard to find the most experienced people to bring on board. Similarly, some new firms never form an

advisory board, whereas others persuade the most important (and influential) people they can find to provide them with counsel and advice. In general, the way to impress potential investors, partners, and employees is to put together as strong a team as possible. Investors and others know that experienced personnel and access to good-quality advice contribute greatly to a new venture's success.

8.2.1. Sole founder or co-founders

Founders' characteristics and their early decisions significantly affect the way an entrepreneurial venture is received and the manner in which the new-venture team takes shape. The size of the founding team and the qualities of the founder or founders are the two most important issues in this matter.

Figure 8.1 The elements of a new venture team

(Source: Barringer and Ireland, 2016)

If a new venture is started by more than one person, it's important that the founders have a good rapport and complement one another rather than duplicate one another in terms of skills and backgrounds.

Size of the Founding Team

The first decision that most founders face is whether to start a firm on their own or whether to build an **initial founding team**. Studies show that 50 to 70 percent of all new firms are started by more than one individual. However, experts disagree about whether new ventures started by a team have an advantage over those started by a sole entrepreneur. Teams bring more talent, resources, ideas, and professional contacts to a new venture than does a sole entrepreneur. In addition, the psychological support that co-founders of a business can offer one another can be an important element in a new venture's success. Conversely, a lot can go wrong in a partnership-particularly one that's formed between people who don't know each other well. Team members can easily differ in terms of work habits, tolerances for risk, levels of passion for the business, ideas on how the business should be run, and similar key issues. If a new-venture team isn't able to reach consensus on these issues, it may be handicapped from the outset.

When a new venture is started by a team, several issues affect the value of the team. First, teams that have worked together before, as opposed to teams that are working together for the first time, have an edge. If people have worked together before and have decided to partner to start a firm together, it usually means that they get along personally and trust one another. They also tend to communicate with one another more effectively than people who are new to one another. Second, if the members of the team are **heterogeneous**, meaning that they are diverse in terms of their abilities and experiences, rather than **homogeneous**, meaning that their areas of expertise are very similar to one another, they are likely to have different points of view about technology, hiring decisions, competitive tactics, and other important activities. Typically, these different points of view generate debate and constructive conflict among the founders, reducing the likelihood that decisions will be made in haste or

without the airing of alternative points of view. A founding team can be too big, causing communication problems and an increased potential for conflict. The sweet spot is two to three founders. A founding team larger than four people is typically too large to be practical.

There are three potential pitfalls associated with starting a firm as a team rather than as a sole entrepreneur. First, the team members may not get along. This is the reason investors favor teams consisting of people who have worked together before. It is simply more likely that people who have gotten along with one another in the past will continue to get along in the future. Second, if two or more people start a firm as "equals," conflicts can arise when the firm needs to establish a formal structure and designate one person as the chief executive officer (CEO). If the firm has investors, the investors will usually weigh in on who should be appointed CEO. In these instances, it is easy for the founder that wasn't chosen as the CEO to feel slighted. This problem is exacerbated if multiple founders are involved and they all stay with the firm. At some point, a hierarchy will have to be developed, and the founders will have to decide who reports to whom. Some of these problems can be avoided by developing a formal organizational chart from the beginning, which spells out the roles of each founder. Finally, if the founders of a firm have similar areas of expertise, it can be problematic.

Qualities of the Founders

The second major issue pertaining to the founders of a firm is the qualities they bring to the table. In the previous several chapters, we described the importance investors and others place on the strength of the firm's founders and initial management team. One reason the founders are so important is that in the early days of a firm, their knowledge, skills, and experiences are the most valuable resource the firm has. Because of this, new firms are judged largely on their "potential" rather than their current assets or current performance. In most cases, this results in people judging the future prospects of a firm by evaluating the strength of its founders and initial management team.

Several features are thought to be significant to a founder's success. The level of a founder's education is important because it's believed that entrepreneurial abilities such as search skills, foresight, creativity, and computer skills are enhanced through obtaining a college degree. Similarly, some observers think that higher education equips a founder with important business-related skills, such as math and communications. In addition, specific forms of education, such as engineering, computer science, management information systems, physics, and biochemistry, provide the recipients of this education an advantage if they start a firm that is related to their area of expertise.

Prior entrepreneurial experience, relevant industry experience, and networking are other attributes that strengthen the chances of a founder's success. Indeed, the results of research studies somewhat consistently suggest that prior entrepreneurial experience is one of the most consistent predictors of future entrepreneurial performance. Because launching a new venture is a complex task, entrepreneurs with prior start-up experience have a distinct advantage. The impact of relevant industry experience on an entrepreneur's ability to successfully launch and grow a firm has also been studied. Entrepreneurs with experience in the same industry as their current venture will have a more mature network of industry contacts and will have a better understanding of the subtleties of their respective industries.

A particularly important attribute for founders or founding teams is the presence of a mature network of social and professional contacts. Founders must often "work" their social and personal networks to raise money or gain access to critical resources on behalf of their firms. Networking is building and maintaining relationships with people whose interests are similar or whose relationship could bring advantages to a firm. The way this might play out in practice is that a founder calls a business acquaintance or friend to ask for an introduction to a potential investor, business partner, or customer. For some founders, networking is easy and is an important part of their daily routine. For others, it is a learned skill.

Table 8.1 Preferred attributes of the Founder or Founders of an entrepreneurial venture

Attribute	Explanation
Firm started by a team	New ventures that are started by a team can provide greater resources, a broader diversity of viewpoints, and a broader array of other positive attributes than ventures started by individuals.
Higher education	Evidence suggests that important entrepreneurial skills are enhanced through higher education.
Prior entrepreneurial experience	Founders with prior entrepreneurial experience are familiar with the entrepreneurial process and are more likely to avoid costly mistakes than founders new to the rigors of the entrepreneurial process.
Relevant industry experience	Founders with experience in the same industry as their new venture will most likely have better-established professional networks and more applicable marketing and management expertise than founders without relevant industry experience.
Broad social and professional network	Founders with broad social and professional networks have potential access to additional know-how, capital, and customer referrals.

(Source: Barringer and Ireland, 2016)

The management team and key employees

Once the decision to launch a new venture has been made, building a management team and hiring key employees begins. Start-ups vary in terms of how quickly they need to add personnel. In some instances, the founders work alone for a period of time while the business plan is being written and the venture begins taking shape. In other instances, employees are hired immediately.

One technique available to entrepreneurs to help prioritize their hiring needs is to maintain a skills profile. A skills profile is a chart that depicts the most important skills that are needed and where skills gaps exist.

Evidence suggests that finding good employees (and certainly good key employees) today is not an easy task and recruiting workers who were comfortable in a small business setting is difficult.

To save money, increase flexibility, and mitigate the difficulty in finding good employees, new ventures use four different sources of labor to get their work done. These are shown in Table 8.2.

Table 8.2. Sources of labor that new ventures Utilize to get their Work Done

Type of labor	Description
Full- or part-time employee	Someone who works for a business, at the business's location, utilizing the business's tools and equipment and according to the business's policies and procedures
Intern	A person who works for a business as an apprentice or trainee for the purpose of obtaining practical experience
Freelancer (or contractor)	A person who is in business for themselves, works on their own time with their own tools and equipment, and performs services for a number of different clients
Virtual assistant	A freelancer who provides administrative, technical, or creative assistance to clients remotely from a home office

(Source: Barringer and Ireland, 2016)

Many founders worry about hiring the wrong person for a key role, regardless of whether the person is an employee, an intern, a freelancer, or a virtual assistant. Because most new firms are strapped for cash, everyone who

is hired must make a valuable contribution. It's not good enough to hire someone who is well intended but who doesn't precisely fit the job. On some occasions, key hires work out perfectly and fill the exact roles that a firm's founders need.

The roles of the Board of Directors

If a new venture organizes as a corporation, it is legally required to have a board of directors-a panel of individuals who are elected by a corporation's shareholders to oversee the management of the firm. A board is typically made up of both inside and outside directors. An inside director is a person who is also an officer of the firm. An outside director is someone who is not employed by the firm. A board of directors has three formal responsibilities:

(1) appoint the firm's officers (the key managers), (2) declare dividends, and

(3) oversee the affairs of the corporation.

In the wake of corporate scandals such as Enron, WorldCom, and others, there is a strong emphasis on the board's role in making sure the firm is operating ethically. One outcome of this movement is a trend toward putting more outsiders on boards of directors, because people who do not work for the firm are usually more willing to scrutinize the behavior of management than insiders who work for the company. Most boards meet formally three or four times a year. Large firms pay their directors for their service. New ventures are more likely to pay their directors in company stock or ask them to serve without direct compensation-at least until the company is profitable. The boards for publicly traded companies are required by law to have audit and compensation committees.

Provide expert guidance Although a board of directors has formal governance responsibilities, its most useful role is to provide guidance and support to the firm's managers. Many CEOs interact with their board members frequently and obtain important input. The key to making this happen is to pick board members with needed skills and useful experiences who are willing to give advice and ask insightful and probing questions.

Lend legitimacy Providing legitimacy for the entrepreneurial venture is another important function of a board of directors. Well-known and respected board

members bring instant credibility to the firm. Achieving legitimacy through high-quality board members can result in other positive outcomes. Investors like to see new-venture teams, including the board of directors, that have people with enough clout to get their foot in the door with potential suppliers and customers. Board members are also often instrumental in helping young firms arrange financing or funding.

Table 8.3. Attributes of effective boards of Directors and effective board Members

Attributes of Effective Boards of Directors

- Strong communication with the CEO
- Customer-focused point of view
- Complementary mix of talents
- Decisiveness
- Mutual respect and regard for each other and the firm's management team
- Ability and willingness to stand up to the CEO and top managers of the firm
- Strong ethics

Attributes of Strong Board Members

- Strong personal and professional networks
- Respected in their field
- Willingness to make personal introductions on behalf of the firm
- Strong interpersonal communication skills
- Pattern recognition skills
- Investment and/or operating experience
- Ability and willingness to mentor the CEO and the firm's top managers

(Source: Barringer and Ireland, 2016)

Rounding Out the team: the role of professional advisers

Along with the new-venture team members we've already identified, founders often rely on professionals with whom they interact for important counsel and advice. In many cases, these professionals become an important part of the new-venture team and fill what some entrepreneurs call "talent holes."

Board of advisors

Some start-up firms are forming advisory boards to provide them direction and advice. An advisory board is a panel of experts who are asked by a firm's managers to provide counsel and advice on an ongoing basis. Unlike a board of directors, an advisory board possesses no legal responsibility for the firm and gives nonbinding advice. As a result, more people are willing to serve on a company's board of advisors than on its board of directors because it requires less time and no legal liability is involved. A board of advisors can be established for general purposes or can be set up to address a specific issue or need. For example, some start-ups set up customer advisory boards shortly after they are founded to help them fine-tune their initial offerings. Similar to a board of directors, the main purpose of a board of advisors is to provide guidance and lend legitimacy to a firm. The most important thing that advisory board members can do is make high-level introductions to early customers, suppliers, and business partners.

Most boards of advisers have between 5 and 15 members. Entrepreneurial firms typically pay the members of their board of advisors a small honorarium for their service either annually or on a per-meeting basis. Boards of advisors interact with each other and with a firm's managers in several ways. Some advisory boards meet three or four times a year at the company's headquarters or in another location. Other advisory boards meet in an online environment.

Although having a board of advisors is widely recommended in start-up circles, most start-ups do not have one. As a result, one way a start-up can make itself stand out is to have one or more boards of advisors.

Lenders and investors

lenders and investors have a vested interest in the companies they finance, often causing these individuals to become very involved in helping the firms they fund. It is rare that a lender or investor will put money into a new venture and then simply step back and wait to see what happens. In fact, the institutional rules governing banks and investment firms typically require that they monitor new ventures fairly closely, at least during the initial years of a loan or an investment.

The amount of time and energy a lender or investor dedicates to a new firm depends on the amount of money involved and how much help the new firm needs. For example, a lender with a well-secured loan may spend very little time with a client, whereas a venture capitalist may spend an enormous amount of time helping a new venture refine its business model, recruit management personnel, and meet with current and prospective customers and suppliers. In fact, evidence suggests that an average venture capitalist is likely to visit each company in a portfolio multiple times a year. This number of visits denotes a high level of involvement and support.

As with the other nonemployee members of a firm's new-venture team, lenders and investors help new firms by providing guidance and lending legitimacy and assume the natural role of providing financial oversight. In some instances, lenders and investors also work hard to help new firms fill out their management teams. Sometimes this issue is so important that a new venture will try to obtain investment capital not only to get access to money, but also to obtain help hiring key employees.

Bankers also play a role in establishing the legitimacy of new ventures and their initial management teams. Research evidence rather consistently suggests that the presence of bank loans is a favorable signal to other capital providers. Investors often take a seat on the boards of directors of the firms they fund to provide oversight and advice. It is less common for a banker to take a seat on the board of directors of an entrepreneurial venture, primarily because bankers provide operating capital rather than large amounts of investment capital to new firms.

Review Questions

1. What is a new-venture team?

2. Who are the primary participants in a start-up's new-venture team?

3. What is liability of newness?

4. What can a new venture do to overcome the liability of newness?

5. Do new ventures started by a team have an advantage over new ventures started by a sole entrepreneur, or is the opposite the case?

6. What are the differences between a heterogeneous and a homogeneous founding team?

7. Why does having relevant industry experience help the founder of a firm?

8. What is networking and why is it important for an entrepreneur to have a vibrant social and professional network?

9. What is a board of directors?

10. What is the purpose of forming an advisory board?

11. What are the different ways advisory boards meet and conduct their business?

12. What are the guidelines to follow when establishing a board of advisors?

13. In what ways do lenders and investors lend legitimacy to a firm?

CHAPTER 9:
FINANCIAL ISSUES OF ENTREPRENEURSHIP

Abstract:

In this chapter, the importance of financing for entrepreneurial success is firstly emphasized, and then we describe two forms of capital in the corporate's capital structure. We follow this with a description of personal funding by explaining three sources including personal funds, capital from friends and family and bootstrapping in the early stage of a firm. When the initial capital exceeds the company' needs, entrepreneurs need to prepare a detailed three-step plan to raise capital through equity funding and debt financing. Finally, we discuss some other creative financing methods available to entrepreneurial ventures.

Learning objectives:

By the end of this chapter, students will be able to:

1. Explain how important financing is for entrepreneurial success
2. Distinguish two forms of capital structure comprising equity and debt
3. Recognize the three sources of personal financing available to entrepreneurs
4. Describe the progress to get financing or funding
5. Explain common sources of equity funding and debt financing offered for entrepreneurial firms.
6. Recommend several innovative sources of financing for entrepreneurial firms to use

CASE STUDY: The startup story of the founder of "cult" e-commerce site Tiki - Tran Ngoc Thai Son

Tran Ngoc Thai Son was born in 1981. He is the founder and CEO of Tiki.vn, one of the leading e-commerce websites in Vietnam with rapid growth. He graduated with a master's degree in e-commerce from the University of New South Wales, Australia in 2007. After that, he spent some time working as a Web designer for Impaq Interactive in Thailand. Returning to Vietnam, he has held various positions such as Marketing Director for Vinabook and Operations Manager at Vega (Clip.vn). The startup story of Tran Ngoc Thai Son with Tiki.vn started when he was a 30-year-old young man. Realizing the demand of Vietnamese consumers to buy and read books, especially for foreign language books, he thought of tools to help people buy books more easily. In 2010, his starting capital to open a company with Tiki.vn website was only 5.000 USD in his savings. The name Tiki.vn derived from the abbreviation of the words “tien loi” (convenience) and “tiet kiem” (save) in Vietnamese. At that time, Tiki only sold English books with more than 100 books, warehouse in garage and office in Mr. Son's bedroom. If there is an order, the packer and the deliverer is himself. These are extremely difficult days because of little capital and difficulty in finding more co-founders for more support, however Mr. Son never gives up. For 2 consecutive years, Tiki held the position of "The most popular customer care service", "The most popular delivery" and "The most popular B2C model e-commerce website in the book industry" by consumers’ votes.

Although the startup story is difficult, Mr. Son’s efforts have obtained remarkable results. In March 2012, Tiki received the investment of Soichi Tajima - Chairman and CEO of CyberAgent Ventures Inc. As a result, by August 2012, his website Tiki.vn had 80 employees, offices, warehouses, and became the number 1 online bookstore in Vietnam. The main milestone is 2016, when Tiki received 384 billion VND from VNG Joint Stock Company. Thanks to this investment, Tiki has more conditions to develop software systems and technology. Tran Ngoc Thai Son realizes the potential of

developing e-commerce in Vietnam, with shopping and consumption habits gradually changing to online shopping. Therefore he transformed Tiki into a multi-industry retail website. Tiki's ambition is to become a leading e-commerce site in Vietnam. Tiki.vn e-commerce website so far offers products in 10 categories as follows: Books, Phones - Tablets, Digital Devices - Digital Accessories, Household Electrical Appliances, Home Life, Beauty - Health, Stationery Equipment, Toys - Souvenirs, Mother & Baby, Sports. His company has suffered losses because of the excessive operating expenses. In 2018, Tiki continues to receive investment from Chinese firm JDar Inc and South Korea's STIC Investment Company with a sponsor of a $ 54 million Series C round to help bolster Tiki's presence on the market.

Moreover, According to the Dealstreet Asia, despite a loss of trillions of dong and influence of Covid 19 pandemic, TiKi has successfully raised an additional $130 million in its latest fundraising round, led by private fund company Northstar Group. It is known that this round of capital mobilization is expected to earn 150 million USD if there are more interested investors. This will create a huge advantage for TiKi in the context of increasingly fierce competition in the e-commerce arena, with today's extremely strong competitor Lazada, backed by the "big" Alibaba and Shopee under SEA. Therefore, it can be seen that capital is not only important to startups in the first stage of operation, but also affects future business results and corporate strategies.

(Source: The startup story of the founder of "cult" e-commerce site Tiki - Tran Ngoc Thai Son, 2019)

Questions:

1. Discuss the importance of getting financing for enterprises, especially for start-ups.

2. Discuss some sources of financing that Tiki got in this case study.

9.1. The importance of getting financing or funding

Any entrepreneurial firm which wants to be successful needs to care about how to have enough capital for business activities. Capital is the prerequisite condition for the existence and development of an enterprise, and enhances the competitiveness of the business. Capital is the basis for establishing the legal status of an enterprise, and guaranteeing for business activities to achieve the set objectives.

Capital is the decisive factor to expand the scope of business activities. Capital is also the basis for enterprises to continue to invest in production, penetrate into potential markets, thereby expanding consumption markets, improving the reputation of enterprises in the marketplace.

Nevertheless, many people have difficulty in raising investment capital. It can be explained that they may lack experience in capital mobilization and they do not know various ways to get financing. As a result, their managers are often affected and dependent on certain sources of funding. This also makes the capital mobilization of enterprises become limited, and then the capital mobilized by enterprises is not enough to meet enterprises' needs for business operation. Therefore, entrepreneurs need to understand fully about the importance of raising money for firms to survive and develop. Everything has two sides and raising money is not an exception. Although a venture always needs money to maintain its operation, it does not want to deal with people who do not understand or care about its long-term goals.

At first, many entrepreneurs thought that they would launch their businesses internally. Because they think that their own capital (equity) will save costs and not change ownership, decision or business management. However, when the business goes into operation, they do know that operating without additional capital sources such as investment capital or borrowings is much more difficult than they anticipated. Hence, it is important for entrepreneurs to understand the role of raising capital for business survival, operation and success.

9.2. Two forms of capital structure

Capital structure is the particular combination of equity and debt used by a company to finance its overall operations and growth. Each type of capital (equity or debt) has its own benefits and limitations and an important part of management. Furthermore, a key element in smart business management is trying to find the perfect capital structure in terms of risk/reward for shareholders.

To raise capital for business needs, firms primarily have two types of financing as an option: equity financing and debt financing. However, most firms use a combination of debt and equity financing.

9.2.1. Equity and equity financing

Equity is the remainder of the value of an enterprise's assets after offsetting liabilities. Equity is also the capital sources owned by the business owner, members of a joint venture or shareholders in a joint stock company. Equity is one of the regular sources of funding in an enterprise, only when the enterprise stops operating or goes bankrupt, it is necessary to use the entity's assets to prioritize payment for creditors, salaries for employees, tax paid to the state, then the remaining asset are divided among the owners according to their proportion of their capital contribution.

Equity financing (or funding) refers to the exchange of partial ownership in return for capital (funding). The common sources of equity funding comprise angel investors, private placement, venture capital, and initial public offerings. For example, the firm X needs to raise capital to fund business expansion. The owner of X decides to give up 30% ownership of the firm and sell it (in the form of stock) to two investors in return for capital. These investors now own 30% of the firm and then have a voice in all business decisions.

If a firm funds by equity financing, it does not have any obligation to repay the money acquired through it. Thus, equity financing has no additional burden on the company. Because there is no requirement for monthly payments

associated with equity financing, the company has more capital available to invest in growing the business. But, there is also downside to equity financing. The main disadvantage is the percentage of ownership as well as the profits and benefits the company must give to investors. It is clear that the cost of equity financing is more expensive than that of debt financing.

9.2.2. Debt and debt financing

Debt is the amount of money a company borrows from external sources for a certain period through the issuance of fixed-rate bonds… Debt is the capital that a company increases by borrowing money. It is a loan made to a company that is normally repaid on a number of days in the future. Debt is different from equity because the borrower does not become the owner of the business, merely creditors and loan providers, and usually receives the percentage of annual contractual fixed on their loan (called a coupon). Loans rank higher than equity related to paying annual returns. This means that legally, interest on debt must be repaid in full before any dividends are paid out to any equity provider.

Debt financing refers to the borrowing of money and paying it back with interest. The most common form of debt financing is a loan. For instance, the company X intends to expand its business by purchasing new equipment with an initial cost of $20 million. The company X obtains a business loan from a bank in the amount of $20 million, with an interest rate of 10%. The loan must be paid back in five years.

Compared to equity financing, debt financing has numerous advantages. Firstly, the lender has no control over the business. Secondly, the interest paid is tax deductible. Thirdly, the expenses can be forecast since loan payments are fixed in the contract. However, debt is still an expense and must be paid on regular schedule. If the company maintains high proportion of debt in the capital structure, this could influence on the company's ability to grow or even go bankrupt.

9.3. Sources of personal financing

Before raising capital from external sources to finance business operations, the initial capital for starting businesses coming from the founders' own pockets. There are three sources of money in this area: personal funds, friends and family and bootstrapping.

9.3.1. Personal Funds

Most of the founders contribute personal funds along with sweat equity to their ventures. Sweat equity refers to the value of the time and effort which a founder put into a new venture. This term is commonly used in the real estate and construction industries. Sweat equity is also an important part of the corporate world, creating value from the effort and worked contributed by an owner and employees of a company.

9.3.2. Friends and Family

Friends and family are the second source of funds for many new ventures, commonly involving loans or investment. However, the entrepreneurs also consider raising money from friends and family members in the forms of outright gifts, foregone or delayed compensation (if they work for the new venture) or reduced or free rent.

One important thing before raising capital from friends and family, the founders should put their personal funds to invest in their ventures. After all, they cannot ask anyone (friends, family or even strangers) for their businesses which they would not dare put their own money. There are three conventional rules that entrepreneurs should follow when asking friends and family member for money (Barringer and Ireland, 2016). Firstly, raising funds from friends and family should like other investors. Therefore, the entrepreneurs should request in a professional way by presenting both the potential of the business and the risks involved carefully and completely. Secondly, if the capital received is debt financing, the entrepreneur should prepare a promissory note, in which repayment schedule is listed in detail and signed by both parties. Thirdly, the request for financial help should only come from appropriate friends and

family members. Raising capital from relatives and friends is sometimes a "double-edged sword", hence entrepreneurs need to be cautious about who they should ask for money. They would never expect this to damage both their business relationship and their friendships.

Jody Porowski, the founder and CEO of Avelist - a community resource website suggest some different fundraising methods from family and friends.

Option 1: Send email extensively

When starting the first round of fundraising, I wrote an email to explain the company's vision, progress by sending myself and BCC to a lot of people. I asked if any of them would be interested in working with us financially. And I say they are free to forward this email to people who might be interested. Remember: "Friends and family" is a broad concept. This is your chance to reach out to people. I'm serious. That may include the teacher who taught you in 5th grade.

Option 2: Send a private message

Sometimes I think of someone who might be interested in this investment but I do not know them. In this situation, I would find someone who knew them and would gladly tell them about my company. Many times this turned into a meeting and often an investment.

Option 3: Group event

I organized several information sessions that serve snacks, drink and PowerPoint presentations. These events brought a team of consultants, potential investors and social media members to the same room to talk about Avelist's vision. I always mention that we are raising capital from friends and family and ask people to contact me if they are interested. This is a great way to tell people about investment opportunities without exposing them to the dilemma.

Option 4: In person

In some situations (for example if someone has ever interested in start-ups), I will ask them directly if they are interested in investing. They are used

to straightforward business conversations, so make sure you are also straightforward.

Tell them you just started a company and you are raising money. Ask them if they would like to know more about the company and its investment opportunities. You can ask by email, by phone or in person.

Remember: This is business, not personal stuff.

You have to be confident. Tell them about the opportunities and see if they want to participate. Above all, it is not that you are asking for charity money or sponsorship.

You are giving people a chance to reap a return on their investment. Believing in your company is the first step in getting people to believe it. And do not take it personally if people say no. A good friend of mine said during my fundraising process: "You have the right to ask me to invest and I have the right to decide whether or not". I really like this statement.

However, it is really personal.

Please protect the relationship. Don't, I repeat, don't make too many promises. I told each investor that they could lose everything they pour into the company and do not invest anything they would not dare lose.

I told them about the opportunities and the risks. It is up to them to decide if they want to support us. If someone is having trouble deciding then I will them not to invest. I also tell each person that I care more about them and our relationship than their money. And I really think so.

I understand how much you want to raise capital for your company but I encourage you to think about the nooks and crannies of a partnership with each investor. Has your relationship with them been complicated lately? If so, don't accept their money! Choose carefully who will become your investor and choose who considers this as a business transaction.

In short, doing business with loved ones is difficult; you need to do everything you can to make it into a good situation.

Seriously: Hire a lawyer

Hiring a lawyer is the best way to protect your investor relationship and protect your company. No matter how well you know these people and whether

the investor is difficult or not, you still need to be serious. Find an attorney in your industry and startups. Why is this important?

First of all, there are a lot of fundraising lawsuits and you don't want things to get messed up. Legal mistakes can affect you, including negative effects on the next round of funding. Professional investors don't want to deal with your messy legal work or complicated pressure from your family. Keep everything clean, simple and think long term!

No matter how good your relationship with a friend or family member is, a contract will put everything in the business deal, which is what you want. Putting down everything in writing will make everything clear to everyone. Even if a friend or relative says that you don't need a contract, you should still make a contract.

Treat friends and family like any other investor.

Friends and family members may trust you because they have known you for a long time, but they may not be clear about your professional qualifications. The more formal your fundraising process, the more investors your friends and family will trust in you. Set up an advisory board. Get in all together in one official offering. Show them you are serious!

Finally, remember that your friends and family members are real investors and they deserve your respect. When they pay for your company, they become your partner. Keep them up to date with your company's progress. Every quarter, I update data, upcoming projects and team changes with investors.

Be willing to invest your own money

In addition to raising capital from friends and family, I also put out pocket money in the company. After all, I cannot ask anyone (friends or strangers) for something I wouldn't dare put money in myself.

If you don't have your own money to invest, consider other ways to invest in your company and show your commitment. You have the time, the talent, the passion and the energy. How many hours per week are you working? What did you give up? How much of your mental energy has your company consumed? If you are raising money from friends and family, then you should be ready to give your company all that you have!

9.3.3. Bootstrapping

The third source of personal financing to seed money for new ventures is bootstrapping. Financial bootstrapping is a technique used by many entrepreneurs to finance their business in the early startup phase when accessing to traditional forms of capital comprising debt or equity are limited. Bootstrapping is considered as "a variety of ingenious methods that find resources, maximize their efficient use and minimize the explicit costs associated with using these means whether they are found inside the business, obtained from other people, or provided by other companies and organizations". Some examples of bootstrapping methods are listed in Table 9.1. There are a lot of renowned examples of entrepreneurs who starting their business by bootstrapping in the world. Apple Company is the product of bootstrapping method when founders including Steve Jobs and partner Steve Wozniak had to sell a Wolkswagen van and a Hewlett-Packard programmable calculator to rase $1,350 to start up. The home search platform Estely is also a successful company by bootstrapping to start. In 2007, Galen Warrd quit his job and persuade his partner Douglas Cole to drop out of school to join his business. With enough personal finances to cover a year of life, the two co-founders invested a total of $4,000 to buy a low-cost server, pay the start-up fee and maintain some other small expenses. The company has grown from a personal investment of $4,000 to a revenue of $1 million, reported in 2014.

However, there are still some elusive disadvantages when using bootstrapping. Obviously, cost-cutting or saving money sometimes cannot push the business to reach full potential as expected. Furthermore, bootstrapping may not fund a company sufficiently to achieve a reasonable level of success. Thus, entrepreneurs should prepare other methods to raise capital.

Table 9.1: Examples of Bootstrapping Methods

No	Bootstrapping methods
1	Minimal Asset Cost including the buying of used equipment, the use of temporary employees or sharing of employees with another business, using business incubators for office space, and using government resources to assist with expertise and advice…

No	Bootstrapping methods
2	Find an coordination with other businesses
3	Leasing instead of buying
4	Delaying Payables and Minimizing Receivables
5	Minimize personal expenses

Personal Funds	Friends and Family	Bootstrapping
Involves both financial resources and sweat equity. Sweat equity represents the value of the time and effort that a founder puts into a firm.	Often comes in the form of loans or investments, but can also involve outright gifts, foregone or delay compensation, or reduced or free rent.	Finding ways to avoid the need for external financing through creativity, ingenuity, thriftiness, cost-cutting, obtaining grants, or any other means

Figure 9.1: Sources of Personal Financing

(Source: Barringer and Ireland, 2016)

9.4. Steps to raise debt or equity financing

In the early stages of starting a business, business owners often have to use personal funds, relatives or friends' money or bootstrapping. But when the business goes into operation for a while and develops to a certain stage, the initial capital will not be enough to meet the operational needs, then the entrepreneurs will have to think about raising money from debt or equity. This is a very important step for the development of a business, so every business needs to be prepared carefully and firmly when raising equity or debt. A detailed plan consisting of the steps and tasks to be done will be the key to successful capital mobilization. Normally, there are three steps that need to be determined when raising debt or equity financing.

Step 1: Determine precisely how much money the company needs

To be certain about the amount of money required to raise, entrepreneurs need creating and analyzing the company's cash flow statements and projects. All this information should be prepared in the business plan. Knowing exactly how much money the company needs can help entrepreneurs raise enough capital as well as make good impression for potential lenders or investor about professional working style.

Step 2: Determine the most appropriate type of financing or funding

There are two common ways for raising money containing equity and debt (which is described in detailed in section 10.2). Raising capital in the form of debt or equity has certain pros and cons. After analyzing cash flow statements to decide the money the company needs, entrepreneurs have to choose the type of financing or funding that fits for their money needs as well as the characteristics of the business.

Step 3: Developing a strategy for engaging potential investors or bankers

In step 3, entrepreneurs need to complete three more steps to approach to potential investors or bankers. Firstly, an elevator speech (or pitch) must be prepared, in which all business opportunity are summarized concisely and prudently. Barringer (2014) explained reasons why they call it as an elevator speech: "If an entrepreneur stepped into an elevator on the 25th floor of a building and found that by a stroke of luck a potential investor was in the same elevator, the entrepreneur would have the time it take to get from the 25th floor to the ground floor to try to get the investor interested in the business opportunity". The length of most elevator speech is from 45 seconds to 2 minutes. Normally, an elevator speech include 4 parts in total 60 seconds: (1) Describe the opportunity or problem that needs to be solved (20 seconds); (2) Describe how your product or service meets the opportunity or solves the problem (20 seconds); (3) Describe your qualifications (10 seconds); (4) Describe your market (10 seconds). Secondly, entrepreneurs need to identify and prepare a list of the best prospects to contact. Table 9.2 show which type of financing match for which venture's characteristics. A key rule for approaching

a banker or an investor is to get personal introduction. Bankers and investors receive many business plan every day. You cannot guarantee that your business plan will get their notice unless you find someone who know them to introduce you. The third and final step is to prepare a complete business plan for investors or bankers and get ready to make a presentation if requested. A very crucial thing in the presentation is to concentrate why your new venture is worthy for lenders or investors to pour capital.

Table 9.2: Matching an Entrepreneurial Venture's Characteristics with an Appropriate Form of Financing or Funding

Characteristics of the Venture	**Appropriate Source of Financing or Funding**
The business has high risk with an uncertain return:	Personal funds, friends, family, and other forms of bootstrapping
Weak cash flow *High leverage* *Low to moderate growth* *Unproven management*	
The business has low risk with a more predictable return:	Debt financing
Strong cash flow *Low leverage* *Audited financials* *Good management* *Healthy balance sheet*	
The business offers a high return:	Equity
Unique business idea *High growth* *Niche market* *Proven management*	

(Source: Barringer and Ireland, 2016)

9.5. Sources of equity funding

By receiving equity funding, the firms' owners have to share a part of their ownership interest and may lose some control. Investors who invest their money in the form of equity will become shareholders. They often offer their expertise and assistance to help firms develop. Unlike a loan, the firms' owner do not have to pay money back for an equity investor. The investor annually receive dividends payment and get profit by selling the stocks.

There are three most common forms of equity funding involving business angels, venture capital and initial public offering.

9.5.1. Business Angels

Business Angels are private individuals who invest in start-ups and early stage businesses with good growth prospects, usually in exchange for shares in the company. Business Angels use their personal capital in businesses they like either directly or through a business angel networks. The term "angel" was first used in Broadway Theater to describe wealthy individuals providing funds for theatrical productions. Then in 1978, Professor William Wetzel of the University of New Hamshire completed his initial research on how entrepreneurs raised money in the US, in which he used "angel" to mention these investors.

Business Angels are typically individuals who have attained the status of "recognized investors". But this is not a prerequisite. The US Securities and Exchange Commission (SEC) defines a "Recognized Investor" as an investor with net worth of $1 million or more (excluding personal houses) or had an income of 200,000 dollars in the previous 2 years. On the contrary, being a recognized investor is not the same as being an angel investor.

An example of business angel financing is Apple's initial investment capital from Mike Markkula. In 1977, he invested $91,000 in Apple and personally guaranteed another $250,000 in credit lines. However, when Apple went public 1980, his stock price was more than $150 million. Obviously, companies that business angels aim are companies with high growth. They are prepared to take high risks in the hope of high returns. The principal problem

of business angel financing is the informality of the market, thus it is difficult to set up. In the other hand, it is also considered as a strength because business angels generally have prior knowledge of the industry, and then they do not need detailed information about the company.

According to the World Business Angels Investment Forum in 2020, the value of angel investment around the world has increased continuously over the years. In 2019, the total value of angel investments is about $60 billion, a 20% increase from 2018 ($50 billion), and is forecast to grow to $250 billion within 5 to 7 years. So, how do entrepreneurs find a business angel investor? The traditional way is discreetly working a network of acquaintances to see if anyone can make an appropriate introduction. Currently, finding an investment from business angel can be implemented through business angel channels or groups. You can easily register information and connect to potential business angels. The number of organized groups of angels continues to grow in the world, even in Vietnam. Furthermore, surveys suggest that business angels are often more patient than providers of other sources of finance. However, the money available from individual business angels may be limited, and large sums may only be available from a consortium of business angels.

9.5.2. Venture Capital

Venture capital is risk capital, normally provided by a venture capital firm or individual venture capitalist in startups or small businesses… with remarkable growth potential for an equity stake. It seems that it is not any company that are easily receive venture capital because venture capital firms or venture capitalists are all ambitious about their investment. Only some investments which meet essential requirements may attract venture capitalists. These requirements might contain: (1) Aim at a clear target market; (2) excellent in strategic, operational and financial practices; (3) A well-defined strategy towards market leadership; (4) highly motivated individuals with a strong management team in place…

For entrepreneurs who are trying to find the financial help from a venture capital institution, they must understand some crucial factors including: (1) they have to exchange for equity stake in their companies; (2) they need

persuade venture investors that their companies can be successful; (3) the venture institution may want to have a representative appointed to the company's board for caring for its interest or an independent director. After that, entrepreneurs have to contact venture capital organizations in the efforts of finding one or more willing to offer finance. In general, a venture capitalist will consider investing at least $500,000 or more. Additionally, another important part of obtaining venture capital is taking due diligence process, which refers to the process of examining the merits of a potential venture and verifying the main claims made in the business plan. A survey has indicated that around 75% of requests for venture capital are rejected on an initial screening and only about 3% of all requests survive both this screening and further investigation resulting in actual investment. However, once a venture capitalist invests in a company, subsequent investment are executed in rounds (stages) like presented in Table 9.3 below. At that time, the company may also borrow more from banks because the company is currently seen as a lower credit risk.

Table 9.3: Stages (or Rounds) of Venture Capital Funding

Stage or Round	Purpose of the Funding
Seed funding	Investment made very early in a venture's life to fund the development of a prototype and feasibility analysis.
Start-up funding	Investment made to firms exhibiting few if any commercial sales but in which product development and market research are reasonably complete. Management is in place, and the firm has its business model. Funding is needed to start production.
First-stage funding	Funding that occurs when the firm has started commercial production and sales but requires financing to ramp up its production capacity.
Second-stage funding	Funding that occurs when a firm is successfully selling a product but needs to expand both its capacity and its markets.

Stage or Round	Purpose of the Funding
Mezzanine financing	Investment made in a firm to provide for further expansion or to bridge its financing needs before launching an IPO or before a buyout.
Buyout funding	Funding provided to help one company acquire another.

(Source: Barringer and Ireland, 2016)

According to the Vietnam Technology Investment Report recently announced by two venture capital funds Cento Ventures and ESP Capital, in just 2 years, Vietnam has grown from a start-up ecosystem with few activities to develop at the 3rd place among the 6 largest ASEAN, just behind Indonesia and Singapore. The amount of invested capital and the number of technology transactions done increased six fold between the first half of 2017 and the first half of 2019 as shown in Figure 10.2. Compared to business angel funds, venture capital funds are more active in Vietnam. These funds focus on potential startups from an early stage with a lot of capital support, management experience and technology. Outstanding venture capital funds that are investing the most capital into Vietnam comprise 500 Startups Vietnam, DO Ventures, ESP Capital, Hustle Fund, Viet Valley Venture, Next100 and Nextrans.

Figure 9.2: Venture capital deals in Vietnam during 2017-2019

(Source: Asian Venture Capital Journal, 2020)

9.5.3. Initial Public Offering

An Initial Public Offering (IPO) refers to the first sale of stock by a firm to the public. This is seen as another source of equity funding. After the IPO, the company will officially become a public company or a public joint stock company. There are many reasons urging entrepreneurial firms to conduct IPO activities; but four main motivations for businesses can be listed as: (1) easier to access to capital; (2) increase liquidity because when going public, the current owners have a public marketplace where they can simple and orderly make money from selling their shares; (3) brand enhancement; (4) increase employee benefits.

An IPO requires an issuing house (the investment bank that represents the company) to buy back a large volume of shares of a company, to offer them to the public and investing institutions. An issuing houses is normally an investment bank. It might either buy shares in the form of a direct allocation from the company or buy from existing shareholders. In both cases, the issuing house publishes an invitation to the public to subscribe to buy shares, either at a fixed price or on a tender basis. The issuing house accepts responsibility to the public, and gives to the issue the support of its own standing.

IPO can also be considered as a turning point for businesses. Especially for startups, growing enough to become a public company through an IPO is an important goal. This creates a goal for businesses to raise large capital to soon break out. Among Vietnamese startups with a market capitalization of over $100 million, only digital media company Yeah1 has been listed on the stock exchange. Meanwhile, VNG Technology Corporation has not been officially listed on the OTC (Over the counter). Yeah1 said that the company took 12 years to prepare to firstly issue shares to the public, showing the process of preparing legal documents. Therefore, it is more difficult for entrepreneurial firms to raise equity funding through IPO than business angels or venture capital funds.

9.6. Sources of debt financing

Debt financing includes borrowing or selling corporate bonds. Although the policy of capital raising through issuing corporate bonds has been gradually

improved, it is still difficult for a new venture to access and enter this market. Therefore, this part only concentrates on how entrepreneurs can obtain loans.

There are two common types of loans including a single-purpose loan and a line of credit. While a single-purpose loan refers to a specific amount of money that entrepreneurs can borrow and have to repay at a fixed rate and time, a line of credit allows entrepreneurs may borrow a "cap" which they use at their discretion and they must still pay interest.

Debt financing has both advantages and disadvantages. Two main advantages of debt are: (1) debt financing does not influence on the ownership of the company and (2) interest payments create tax shield for the company. On the contrary, debt financing has still some disadvantages. The first is the pressure to pay interest and principal during the payment term, which may be quite difficult for a start-up venture. The second is strict conditions that impose on loans and required collaterals.

The most popular source of debt financing for a new venture is commercial bank. Besides, there are some other sources that described below.

9.6.1. Commercial Banks

In fact, most startups have difficulty in accessing credit from commercial banks. This can be explained by the characteristic of banks is risk averse while new ventures are often seen as risky businesses. Normally, banks prefer lending to companies with stable cash flow, low leverage, good management and healthy accounting balance sheet. Although many new ventures have good management, few have the other characteristics, at least initially. However, banks are an important source of credit for small businesses later in their life cycle.

To help startups get access to loans from commercial banks, governments often conduct preferential policies. The State Bank of Vietnam (SBV) has instructed credit institutions to actively research and develop credit programs and packages with reasonable interest rates as well as simplify loan procedures for small and medium enterprises (SMEs) and startups. In the period of 2017-2018, SBV has twice adjusted the ceiling of short-term lending interest rates in Vietnam Dong (VND) for priority areas. Following the instructions of the State

Bank, a number of state-owned commercial banks and some large joint stock commercial banks have adjusted lending interest rates for priority sectors three times in 2019. At the same time, commercial banks also focus on credit capital used for production and business; proactively approach SMEs and startup customers; offer many priority programs and products. As a result, outstanding loans to SMEs and startups have continuously increased over years. By the end of 2019, credit balance for these customers reached more than 1.6 million VND, accounting for 36.8% of total outstanding loans of enterprises.

9.6.2. Other Sources of Debt financing

In addition to commercial banks, there are a lot of other sources that business owners can access to borrow money or obtain cash. Firstly, **trade credit** is a main source of short term finance for a business. Current assets like raw materials can be purchased on credit, with payment terms normally varying from 30 to 90 days. Therefore, it can be considered as an interest-free short-term loan. In a period of high inflation, purchasing via trade credit will be very helpful in saving and keeping costs down. However, business owners should take into account the loss of discounts suppliers offer for early payment. Furthermore, despite an interest-free loan, businesses should not delay payment too long because it will worsen the company's credit rating and additional credit may become difficult to obtain. Secondly, **factoring** is a method of financing by selling invoices at a small discount (interest rate) with a view to obtain cash in advance of the invoice due date. This is conducted through an intermediary fund provider as a bank, who provides early payment to the supplier in exchange for the discount, and in turn receives later payment from the buyer. This is a technology-based process which links the buyer, the seller and the fund provider. Thirdly, **merchant cash advance** means the lender provides a business an amount of money in exchange for a share of future shares (typically a set percentage of the business's daily credit card sales) that covers the payment amount plus fees. Fourthly, **peer-to-peer lending** (abbreviated as P2P lending) allows individuals to receive loans directly from others, eliminating the role of middleman for financial institutions. Websites that facilitate peer-to-peer lending have grown significantly. Although this type

of loan was just introduced in 2005, there are many competitors including Prosper, Lending Club, Peerform, Upstart and StreetShares.

9.7. Creative Sources of Financing and Funding

For startups, it is sometimes quite difficult to raise capital through debt financing or equity funding. In this circumstance, entrepreneurs often think of using creative ways to receive financial help. Even for firms that are capable of having money by financing or funding, it is careful to search less expensive source of capital than traditional ones. Crowdfunding, leasing and strategic partners are more common creative sources of financing and funding for entrepreneurial firms.

9.7.1. Crowdfunding

Crowdfunding is defined as a form of funding for a project or new venture by raising capital from a large number of individuals or communities, typically via the Internet. This form started in the entertainment field more than 10 years ago, and then become more popular in many different fields such as creative projects, information technology, software… The original idea of community funding is raising capital from a variety of individuals with relatively small amount of money. Through the use of internet tools, a conditional start-up can approach millions of potential investors. Therefore, crowdfunding does not require any intermediaries or financial institutions such as banks, securities companies, insurance, but any individual convinced by the feasibility of business projects provided on fundraising platforms can become investors.

The crowdfunding process begins with business project publishing a funding request on fundraising platform. This fundraising announcement will include information about the product, business plan and the benefits the investors will receive. Crowdfunding can be divided into two main method: Pre-order form and Profit-sharing form (Equity-based)

- Pre-order form is a form of crowdfunding in which project owners urge individuals/investors to “pre-order” products or services that are about to be launched to the market without incurring debt or affecting equity. With this method, capital contributors by placing a pre-order may have to buy a

product/service at a higher price than customers buy after the product is released to the market. However, to offset this difference, capital contributors will receive certain benefits, even if not in money.

- Profit-sharing form is a form of community capital raising in which the project owners call on individuals/investors to contribute money to implement the project in the first phase and exchange for a percentage of share or share profits associated to the amount of capital contributed in this project.

Currently, in Vietnam, many supporting platforms have also been developed, such as Comicola.com, Firtstep.vn, Fundingvn.com or Fundstart.vn. In fact, there are many projects initiated by Vietnamese people that have successfully mobilized community capital when posting information calling on foreign websites like Vu Xuan Son's Misfit Shine fashion wearable project (Sonny Vu) has attracted 846,000 USD with nearly 8,000 individual sponsors through Indiegogo.

9.7.2. Leasing

Leasing is a part of the capital market, dealing with the supply-demand relationship of capital. A lease is a contract agreed between two parties: the lessee and the lessor, in which the lessee is entitled to use the property for a certain period of time and must pay the lessor money during leasing time according to a predetermined term. At the end of lease term, the lessee has the option to stopping using the equipment, purchase the leased property at a price lower than its value at the time of redemption or renew the lease. Most leases cost a moderate down payment and monthly payment during the duration of the lease. However, the principal downside is that the lessee does not own the property or equipment at the end of the lease. Certainly, this may be exceptional if a company lease technological equipment, which can be rather quickly become obsolete.

9.7.3. Strategic partners

Strategic partners are another creative source of capital for new ventures. The term "strategic partner" was first used around the 1990s and 19912, which referred to the relationship between the US and China. Since then, this term has

been widely used. Strategic partnership is a form of cooperation, in which the composition, content, form, degree… completely depends on the initiatives of the parties. A small biotech firm, for instance, rarely have access to sufficient financial capital and other resources to take a new discovery from the lab to the market. As a result, they rely on strategic partners to perform parts of the process comprising plant, equipment, distribution channel in exchange for bringing an entrepreneurial spirit and new ideas. These types of arrangements can help new ventures decrease the need for financing or funding.

Review Questions

9.1. Why is financing important for entrepreneurs' success?

9.2. What is the difference between debt and equity?

9.3. List common sources of personal funding? Which is considered as the best source?

9.4. Why do entrepreneurs have to rely on their personal funds to start their ventures/businesses?

9.5. Describe steps to prepare to raise debt or equity financing.

9.6. What are the most common sources of equity funding?

9.7. Who are Business Angels? What is the difference between Business Angel and Venture Capital?

9.8. List and explain sources of debt financing.

9.9. What is crowdfunding? How many forms of crowdfunding

9.10. Explain how the company raise capital from leasing and strategic partnership?

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